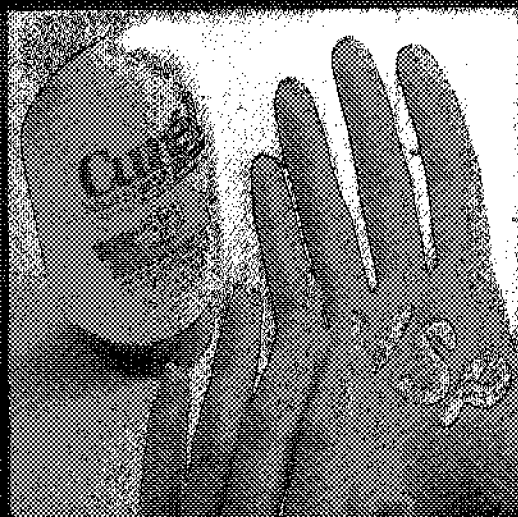


ISP

01222586

INTERNATIONAL SPECIALTY PRODUCTS INC.

The world's leading brands and ISP... YOU CAN'T HAVE ONE WITHOUT THE OTHER.



ISP Products	Function
OMNIREZ [®] 2000; H ₂ OLD [®] EP-1; GANTREZ [®] ES, SP, A GAPQUAT [®] ; STYLEZE [™] CC-10; PVP/VA S-630 PVP/VA W, E, AND I POLECTRON [®] 430; SURFADONE [®] LP STABILEZE [®] 06, QM, XL-80 GAPQUAT [®] ; ESCALOL [®] HP-610 ESCALOL [®] ; GANEX [®] CERASYNT [®] ; CERAPHYL [®] ; GERMALL [®] SUTTOCIDE [®] GANTREZ [®]	Hairspray fixative Hair fixative Hair fixative Opacifier; Foam stabilizer and viscosity modifier Thickener and formulation stabilizer Conditioning agent; Hair protectant UV absorption; Waterproofing agent Emulsifier; Emollient; Preservative Preservative Adhesive
PLASDONE [®] ; POLYPLASDONE [®] GANTREZ [®] S-97 BF, MS-955 PVP-Iodine	Tablet binder; Disintegrant Bio-adhesive Provides a safe, stable iodine disinfectant
AGSOLEx [®] ; AGRIMER [®] POLYCLAR [®] 10; POLYCLAR [®] SUPER R POLYCLAR [®] V, ULTRAFINE, VT	Promotes dispersion or adherence of active ingredient Clarifying and stabilizing agent Clarifying and stabilizing agent
PVP; CHROMABOND [™] ; SURFADONE [®] RAPID-CURE [®] Vinyl Ethers; V-PYROL [®] ; V-CAP [™] PVP; PVP/VA MICROPOWDER [®] IRON VP/V-CAP [™] Copolymers Proprietary intermediate Flunixin Meglumine Grandlure Complete Proprietary custom products Butanediol SHIPSHAPE [®] ; FOAMFLUSH [®] ; PARTSPREP [®] M-PYROL [®] MICROPURE [®] EG, ULTRA II	Dye transfer inhibitor; Wetting agent Reactive diluent; Crosslinker; Monomer building blocks Base resin for water-soluble adhesives Highly pure, submicron iron powder Gas hydrate inhibitors Cancer treatment drug Animal analgesic Cotton boll weevil population control Photographic film Monomer building block, intermediate Solvent Solvent Solvent
Colored roofing granules	Provides weather protection and aesthetics
GAF [®] FILTRATION SYSTEMS; PROGAF [™] ACCUGAF [™] ; SENTINEL [®] RING	Macroscopic bag filtration systems for liquids High efficiency filter bag; Leak-proof ring seal systems

A T A G L A N C E

Customer Applications

HAIR CARE

Hairsprays
Styling gels
Mousses
Shampoos
Two-in-one shampoos
Conditioning rinses

SKIN CARE

Sunscreens
Body and facial moisturizers
Baby wipes
Facial cleansing strips

PHARMACEUTICAL

Tablets and capsules
Tartar control toothpastes, denture adhesives
Surgical scrubs and antiseptic preparations

AGRICULTURAL

Crop protection and treatment products

BEVERAGE

Beer, wine and fruit juices

PERFORMANCE CHEMICALS

Laundry detergents, dishwashing and hard surface cleaners
UV coatings
Glue sticks, hot melt adhesives
High performance pressed metal parts
Oilfield chemicals

FINE CHEMICALS

Drug intermediates and bulk actives
Veterinary drugs
Pheromones
Imaging chemicals

INDUSTRIAL

Flexible plastics for automotive and appliances
Non-toxic industrial cleaners and metal degreasers
Wire coatings
Semiconductors

Asphalt roofing shingles

Chemicals, paints, automotive, food and beverage
Cosmetics, pharmaceuticals

PERSONAL CARE

PHARMACEUTICAL,
AGRICULTURAL AND BEVERAGE

SPECIALTY CHEMICALS

PERFORMANCE CHEMICALS,
FINE CHEMICALS AND INDUSTRIAL

MINERAL PRODUCTS

MINERAL
PRODUCTS

FILTER
PRODUCTS

International Specialty Products Inc. (ISP) is one of the world's premier specialty chemicals companies. The Company has approximately 2,900 employees at more than 70 locations, including manufacturing facilities, research laboratories, and sales and customer service offices throughout the world, serving customers in more than 90 countries.

The Company manufactures three major groups of products -- specialty chemicals, mineral products, and filter products -- and holds a significant market share in each of these principal product groups.

In its largest business, ISP produces a broad spectrum of specialty chemicals, which have a wide range of applications in such markets as pharmaceuticals, hair and skin care, plastics, agricultural, coatings and adhesives. The Company's products, while often representing a relatively small portion of customers' production costs, generally constitute key ingredients in the end products in which they are used. The business is characterized by an emphasis on technology, research and development, marketing and customer service. The Company believes it has been able to sustain its market share positions for its specialty chemicals by establishing and maintaining long-term relationships with its customers and working closely with them to develop chemicals tailored to their specific needs.

ISP's Mineral Products business manufactures ceramic-coated colored roofing granules, which are produced from rock deposits that are mined and crushed at the Company's three quarries and colored using a proprietary ceramic-coating process. The Company's products are sold primarily to the North American roofing industry for use in the manufacture of asphalt roofing shingles, for which they provide weather resistance, decorative coloring and heat deflection.

The Company manufactures filter products, consisting of pressure filter vessels, filter bags and filter systems designed for the treatment of process liquids primarily in the paint, automotive, chemical, pharmaceutical, petroleum and food and beverage industries.

ISP's stock is traded on the New York Stock Exchange under the symbol "ISP."



FINANCIAL HIGHLIGHTS (Thousands, except per share amounts)

OPERATING DATA	1998	1997	1996
NET SALES	\$ 823,938	\$ 749,208	\$ 716,481
GROSS PROFIT	338,568	312,328	297,560
GROSS MARGIN	41.1%	41.7%	41.5%
NONRECURRING CHARGES	85,835	-	-
OPERATING INCOME	69,755	141,304	136,024
OPERATING INCOME <small>(excluding nonrecurring charges)</small>	155,590	141,304	136,024
EBITDA ⁽¹⁾ <small>(excluding nonrecurring charges)</small>	256,929	236,617	206,440
NET INCOME	4,812	54,005	53,933
NET INCOME <small>(excluding nonrecurring charges)</small>	64,114	54,005	53,933
EARNINGS PER COMMON SHARE DATA:			
WEIGHTED AVERAGE SHARES - DILUTED	61,278	53,833	53,833
EARNINGS PER SHARE - DILUTED	\$0.08	\$1.00	\$1.00
EARNINGS PER SHARE - DILUTED <small>(excluding nonrecurring charges)</small>	\$1.05	\$1.00	\$1.00

(1) EBITDA represents earnings before income taxes, increased by interest expense, depreciation and goodwill amortization.

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ISP AT A GLANCE

FINANCIAL HIGHLIGHTS

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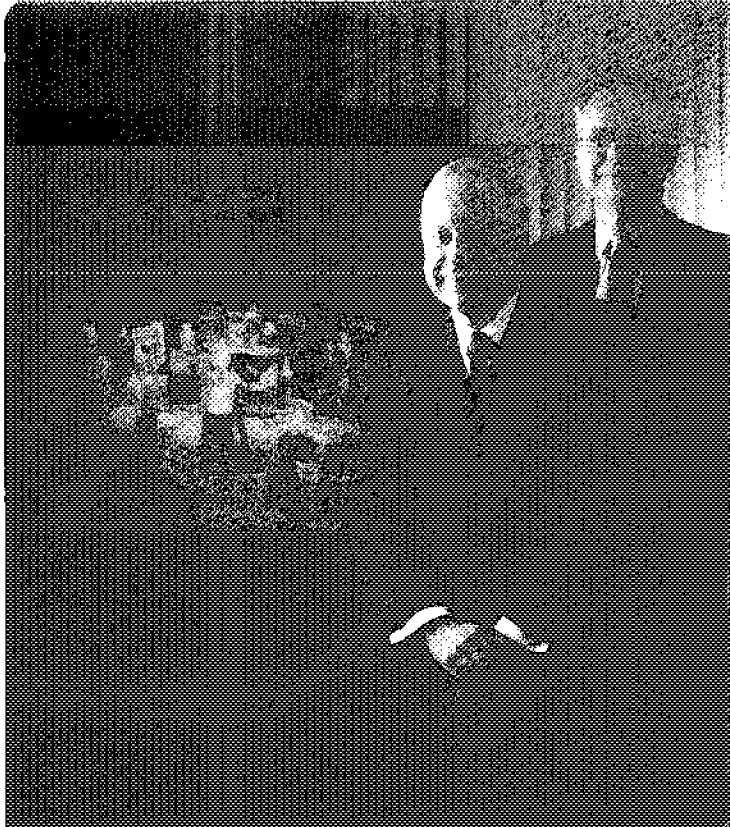
PERSONAL CARE

PHARMACEUTICAL,
AGRICULTURAL AND BEVERAGE

PERFORMANCE CHEMICALS,
FINE CHEMICALS AND INDUSTRIAL

MINERAL PRODUCTS

FILTER PRODUCTS



(left)
SAMUEL J. HYMAN
Chairman of the Board
and Chief Executive Officer

(right)
PETER R. HEINZE
President and
Chief Operating Officer

Fellow Shareholders:

1998 was a disappointing year in terms of ISP's financial performance, with earnings falling short of the double-digit growth rates we have become accustomed to expect. Results were affected by deteriorating economic conditions in the Asia-Pacific region, generally flat pricing for the Company's products as a result of the deflationary environment around the world, and severe competitive conditions in the merchant market for butanediol.

1998 Financial Results

For the 12-month period ended December 31, 1998, excluding several one-time charges, net income was \$64.1 million (\$1.05 per diluted share), compared with \$54.0 million (\$1.00 per diluted share) reported in 1997. Operating income for 1998, excluding the one-time charges, was \$155.6 million compared with \$141.3 million in 1997. One-time charges totaling \$85.8 million were taken in the third and fourth quarters of the year, which charges include \$70 million related to the

write-down of assets associated with the Company's merchant butanediol business, \$12.8 million in connection with the merger of the Company with its parent company, ISP Holdings Inc., and \$3 million for the restructuring of ISP's European operations. Operating income and net income, after these charges, were \$69.8 million and \$4.8 million (8 cents per diluted share), respectively.

Company sales in 1998 were \$823.9 million compared with \$749.2 million in 1997 (up 10%), with the increase principally the result of the acquisition of both the remaining 50% interest in ISP's joint venture in Germany, GAF-Hüls Chemie GmbH ("GhC"), as well as a fine chemicals production facility in Freetown, Massachusetts. The growth in revenues also reflected increased sales in Europe and the United States, partially offset by lower sales in Asia due to the economic difficulties in that region.

Operating income in both 1998 and 1997 was reduced by noncash charges of \$23.5 million and \$21.7 million, respectively, resulting from goodwill amortization (\$15.0 million in 1998 and \$13.2 million in 1997) and stepped-up depreciation (\$8.5 million in both periods), associated with predecessor company transactions. Without these noncash charges and excluding the 1998 one-time charges, operating income for 1998 and 1997 would have been \$179.1 million and \$163.0 million, respectively.

Given the magnitude of the Company's non-cash charges, which are strictly historical in origin, and the fact that ISP's book earnings substantially understate the true cash earnings power of the Company, we believe that ISP's results, without adjustment for these accounting charges, are a more accurate reflection of the Company's performance. Excluding both these noncash charges and all the one-time charges, pro forma net income in 1998 was \$79.2 million (\$1.29 per share) compared with \$66.5 million (\$1.23 per share) in 1997. Another helpful measure of performance, which similarly excludes these noncash and other one-time charges is EBITDA, representing profit before

taxes, increased by interest expense, depreciation, and goodwill amortization, which was \$256.9 million in 1998 compared with \$236.6 million in 1997.

Significant Developments

ISP achieved this past year a host of accomplishments, which included:

- (i) a higher than normal number of new product introductions;
- (ii) the largest capital investment program in any one year in the history of the Company, involving more than \$80 million, consisting for the most part of profit-bearing projects involving capacity expansions, process improvements, and a major upgrade of the Company's management information systems;
- (iii) further progress in connection with ISP's ongoing reengineering effort, resulting in a substantial reduction in the Company's manufacturing conversion costs;
- (iv) continued aggressive cost reduction efforts throughout the Company, which resulted in the consolidation and closing of a number of European offices and Company-wide head count reductions;
- (v) completion of the installation of a \$25 million Enterprise Resources Planning system, involving a complete upgrade of the Company's MIS system, which will enable ISP to improve customer service and effectuate further cost savings; and
- (vi) revisions to ISP's executive compensation program to place greater emphasis on performance-based factors and less on salary.

Developments worthy of special mention are as follows:

(1) Restructuring of ISP's Butanediol Manufacturing Capacity

In light of anticipated increased competition in the butanediol market, ISP moved last year to restructure its butanediol production capacity with a view to substantially improving its cost position:

(a) The Company first acquired last June the remaining 50% interest in its joint venture with Hüls AG, GmbH, whose primary asset is a low-cost butanediol and THF manufacturing facility located in Marl, Germany. As part of the transaction, ISP acquired Hüls' modern production facility that supplies GmbH with its primary raw material, acetylene. The acquisition assures that ISP will have access to low-cost butanediol for both the merchant market and for the production of its downstream polymers; and

(b) The Company decided last December, primarily as a result of the GmbH acquisition, to close its butanediol production unit in Calvert City, Kentucky. While the write-down of the assets entailed a one-time accounting charge of \$70 million, the actual cash cost related to the shutdown is expected to be less than \$10 million.

As a result of these initiatives, the Company has now substantially improved its cost position with respect to the manufacture of butanediol, while maintaining a level of production capacity roughly comparable to that of before.

(2) Continued Growth of ISP's Fine Chemicals Business

ISP's Fine Chemicals business, which comprises a world-class FDA-approved facility in Columbus, Ohio, and a newly acquired fine chemicals manufacturing facility in Freetown, Massachusetts, continued in 1998 to demonstrate exceptional growth. The Columbus business, which specializes in the production of chiral compounds for the pharmaceutical market and has enabled the Company to become a leading innovator in large scale, cold temperature manufacturing under cGMP conditions, registered a fifth consecutive year of double-digit sales and income growth. ISP's capabilities have been recognized by a number of the world's leading pharmaceutical companies, who have entered development agreements with ISP, thereby helping to position the business for continued strong growth.

In February 1998, ISP completed the acquisition of Polaroid Corporation's Freetown, Massachusetts fine chemicals manufacturing facility. The facility possesses large scale, multi-purpose reactor systems that are well suited for fine chemicals manufacturing and includes a versatile, first class pilot plant. ISP plans to develop cGMP capabilities at the site, which will enable it to offer custom manufacturing services there as well. The Polaroid transaction included a multi-year supply agreement in which ISP will supply Polaroid with the polymers and imaging dyes manufactured at the facility for use in Polaroid's instant film business. Finally, not only does the facility provide ISP with additional custom manufacturing capability for third parties, but the Company is in the process of utilizing some of the capacity at the Freetown facility for certain of its own current specialty chemicals product lines.

(3) ISP's Operating Priorities

This past year, management underscored the Company's key operating priorities in order to ensure that every employee remains focused on ISP's profitable growth. These priorities are:

(a) Grow ISP's businesses by establishing customer partnerships

The Company has developed a number of strong partnerships with well-known consumer product and pharmaceutical companies. These partnerships have resulted in the recent development of new products, such as the bio-adhesive resin used in the Chesebrough-Pond's pore strip facial cleansing products and dye transfer inhibition polymers for Wisk® and other laundry detergents. Moreover, these relationships have not only been instrumental in securing proprietary positions for the next generation of these and other products, but so also these customer partnerships have enabled ISP to reduce costs by better controlling its manufacturing and supply chain processes.

ISP continues to believe that strong customer partnerships are critical to its future success and

wishes to pursue and develop further relationships, which can be expected to lead to long-term supply arrangements through multi-generation product development participation. Throughout the discussion of each of the Company's business segments in this Annual Report, we have highlighted some of ISP's recent efforts to establish and capitalize on these customer partnerships.

(b) Become a leader in our chosen markets through innovation

The Company continues to develop new and innovative products not only to meet the needs of its existing customers, but also to enter new markets. New products such as PROLIPID® 141, a gel system that offers formulators long-term moisturization and excellent stability properties for skin care products, enable ISP to maintain a leadership position in the personal care ingredients markets, while products such as the Company's gas hydrate inhibitor (GHI) polymer systems offer new, low-cost customer solutions in relatively new markets for ISP, such as natural gas production.

(c) Achieve operational excellence in every facet of ISP's business

The Company continues to take steps to achieve operational excellence in all aspects of its business. We believe that remaining a world-class Company can only be accomplished through a continued emphasis on improving ISP's competitive manufacturing position, improving the efficiency of its business processes, and increasing the productivity of its people.

In addition to taking the steps outlined earlier relative to restructuring its butanediol manufacturing assets, ISP completed last year a two-year, \$25 million capital investment project involving the upgrade of the Company's management information system. This enterprise-wide system was implemented with a view toward developing the most efficient processes for customer support, quality measurement, and inventory management. The

implementation of this new global information system will further enable the Company to reduce its operating costs through the increased productivity of its people.

ISP's Recapitalization, Stock Price and Share Repurchase Program

ISP's Board of Directors is of the view that management's dominant holding in the Company's shares, and the resulting limited public float, has been the primary reason its stock continues to trade at a substantial discount to specialty chemicals industry averages.

In order to address this concern, on July 15, 1998, the Company implemented a merger of ISP with ISP Holdings Inc., which had the effect of reducing management's ownership interest from 84% to 78% and, more importantly, eliminating the requirement for the parent company to own more than 80% of ISP's stock to avoid adverse tax consequences – thus freeing up ISP to issue additional equity and thereby increase liquidity.

Unfortunately, shortly after completion of the merger, the entire market for specialty chemicals stocks, including ISP, experienced a very substantial correction which has continued to this day, dropping by more than 40%. As a result, it is no longer practicable to issue additional ISP stock at currently depressed prices, although the Company is in a position to do so when ISP's market price returns to a more reasonable level.

In the meantime, with ISP's stock trading as of this writing at about \$7 per share, less than 7 times last year's earnings (excluding nonrecurring charges), ISP's Board approved, on March 24, 1999, the open market purchase of an additional 1.5 million shares of the Company's stock. While the shares to be repurchased will be held for general corporate purposes, the program represents an expression by our Board of its confidence in the future of our Company and so also its belief that our shares remain undervalued in the market.

Prospects for 1999

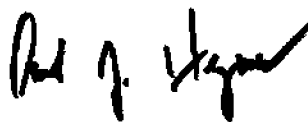
Having fallen short of our expectations in 1998, and given the fact that some of the macroeconomic factors, as well as industry conditions, that affected 1998 performance are expected to be present in 1999, we are taking a cautious stance with respect to the current year. We are confident, however, that we are following the right course, including the making of patient investments in our businesses so as to ensure the long-term health and growth of our Company.

Acknowledgements

We wish to express our appreciation to our customers, suppliers, the Company's Board of Directors, employees, and outside professionals for their contributions to the success of our common endeavor.

We look forward to a successful 1999 and a year of continued accomplishment.

Sincerely,



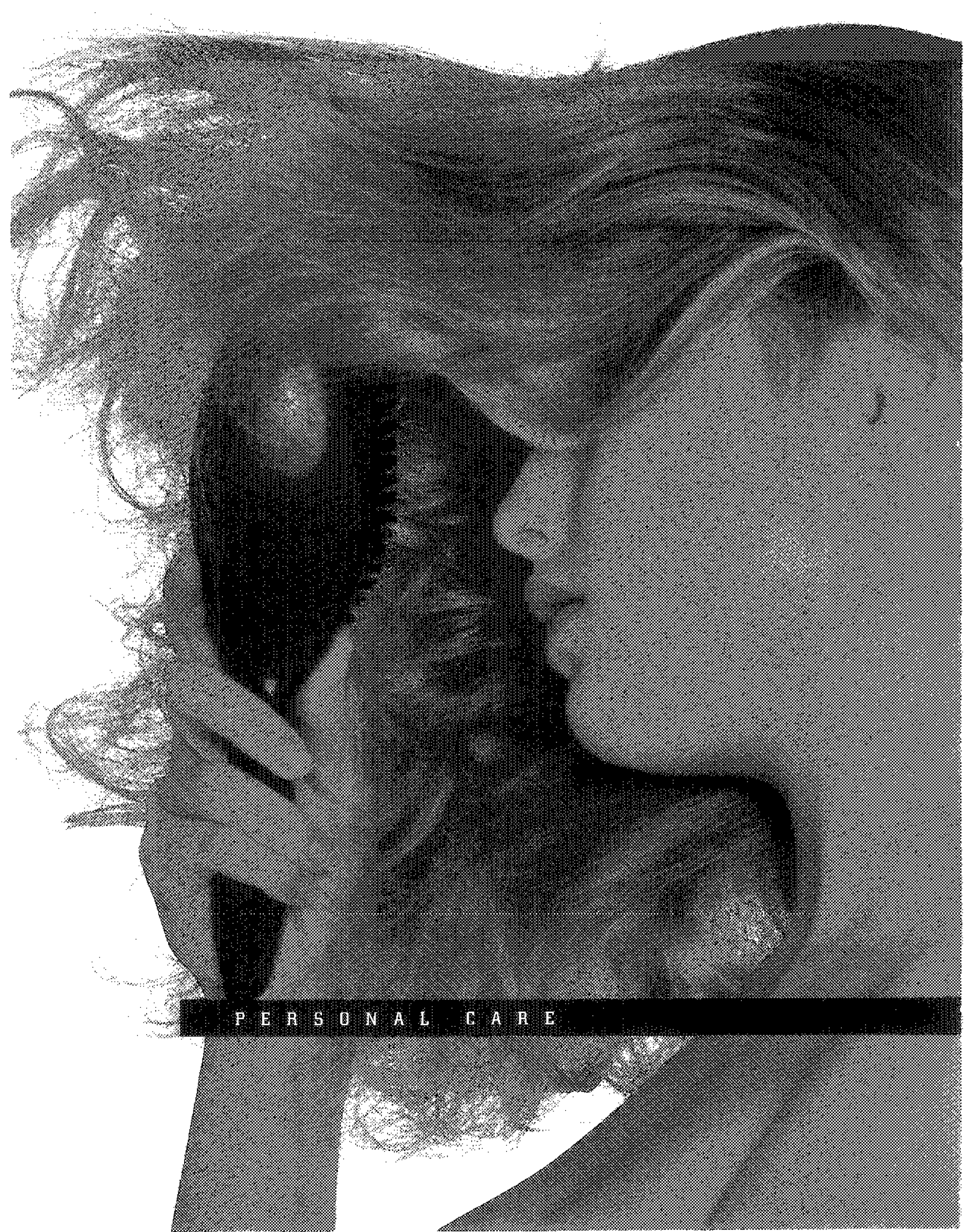
SAMUEL J. HEYMAN
CHAIRMAN OF THE BOARD
AND CHIEF EXECUTIVE OFFICER



PETER R. HEINZE
PRESIDENT AND
CHIEF OPERATING OFFICER

April 8, 1999

5



P E R S O N A L C A R E

PERSONAL CARE

ISP's specialty chemicals serve as critical ingredients in the formulation of many well-known hair care, skin care, toiletry and cosmetic products. The Company's products provide performance-enhancing properties that enable its customers to offer high value-added products to ever-changing competitive markets. Strong customer relationships and innovative product development allow ISP to offer one of the widest ranges of personal care ingredients available from a single supplier.

ISP's skin care ingredients include sunscreen actives, waterproofing agents, preservatives, emollients, emulsifiers and bio-adhesives. The ESCALOL® family of ultraviolet absorption products serves as the primary active ingredient in many of today's sunscreens and increasingly finds application in other cosmetic products, such as lipsticks, facial creams and lotions. The Company's CERAPINE® line of emollients provides a variety of popular skin and cleansing products with their softening and moisturizing characteristics. ISP produces a growing number of specialty preservatives for both skin and hair care applications, including GERMAIL® PLUS, a patented product that offers broad spectrum anti-microbial activity, and SUTOCIDE® A, a preservative gentle enough for infant care products.

ISP's hair care ingredients, which include the GANTREZ®, GAFQUAT®, and PVP/VA families of products, are specially developed fixative resins which impart hold to hairsprays, mousses, and gels. In addition, the Company continues to develop products that enable formulators to meet the government-mandated reduction of volatile organic compounds (VOCs) in hairsprays, while maintaining high-performance characteristics.

INNOVATION

The Company continues to introduce new and innovative products for diverse applications. Two new hairspray resins, AQUAFLEX™ FX-64 and ALLIANZ™ LT-120, were introduced this past year for the emerging 55% VOC market. These products are unique in that they are also effective in 80% and higher VOC formulations. The ALLIANZ™ LT-120 product is the result of a development

program of the strategic alliance between ISP and the Rohm and Haas Company.

Other new products introduced in 1998 include ESCALOL® T, a patented system of organic and inorganic ultraviolet absorption ingredients that provides superior protection to sunscreen formulations, and LIQUID GERMAIL® PLUS, a highly effective cosmetic preservative in a new easy-to-use liquid form. ISP customers utilize these products in existing applications as well as in new markets, such as ethnic skin and hair care products and emulsifier-free skin care products.

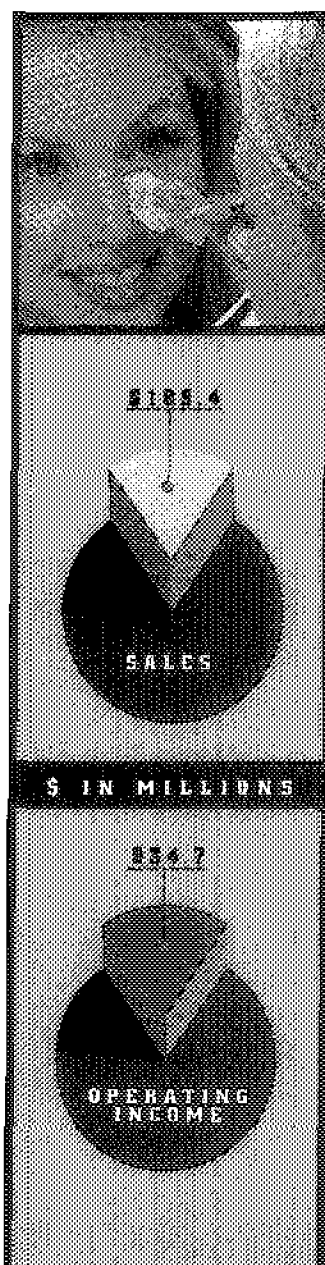
CUSTOMER PARTNERSHIPS

Consistent with its customer-focused strategy, ISP continued to strengthen its relationships with key customers this past year by creating a number of customer-specific, cross-

functional teams whose objectives were to better understand and support that customer's needs. These teams demonstrated their effectiveness by introducing several new products and developing a number of new applications that addressed key customers' performance requirements. The formulation of a GANTREZ® polymer in Chesebrough-Pond's new Clear Pore® Strips is an example of a successful application development program that emerged from an ISP customer partnership. Through a functionally integrated new product development team, which included members of research and development, manufacturing and marketing from both ISP and the customer's organization, ISP was able to meet sharply higher than expected start-up demand for the product so as to allow the customer to achieve a smooth new product introduction.

FINANCIAL PERFORMANCE

The Personal Care business segment remained a key contributor to ISP's profitability, representing 23% of total revenues and 22% of total operating profit before one-time charges. Personal Care revenues for 1998 were \$189.4 million, roughly flat with 1997 revenues of \$187.4 million. Unit volume increases were offset by continued price pressure in sunscreens and slower business in Asia, resulting in operating income in 1998 of \$34.7 million.





PHARMACEUTICAL AGRICULTURAL AND BEVERAGE

PHARMACEUTICAL, AGRICULTURAL AND BEVERAGE

ISP's performance enhancing products for the pharmaceutical, agricultural and beverage markets provide a substantial number of end-use products with their superior properties while at the same time enabling these products to meet increasingly strict regulatory requirements. In the pharmaceutical market, ISP's products serve as key ingredients in both liquid and solid prescription and over-the-counter drugs, antiseptics, toothpastes, denture adhesives and other oral care preparations. ISP is a leading producer of inert ingredients for the agricultural industry, where the Company's solvents and polymers are used in the formulation of safer and more effective crop protection products. And finally, with regard to the beverage market, the Company's specialty products assure the clarity and stability, while also extending the shelf life, of beer, wine, and fruit juices.

INNOVATION

This past year, ISP's PHARMASOLVE®, a pharmaceutical-grade solvent that improves the stability and bio-availability of pharmaceutical compounds that are difficult to put into solution, received FDA approval for use in treating periodontal disease. A key customer plans to launch a new product utilizing PHARMASOLVE® for this application. Another new product developed this past year and formulated specifically for beer, POLYCLAR® PLUS 730, an extension of ISP's POLYCLAR® family of beverage additives, is a dual-acting stabilizer that offers a highly effective method for the prevention of chill haze. The product is designed to take advantage of the synergies between two globally recognized processing aids, providing customer improved performance, longer shelf life and additive-free labeling. ISP also introduced MICROFLEX-1™, a patented, water-based microemulsion that replaces traditional solvents and more effectively disperses the active agricultural ingredient for easier application and improved environmental safety.

CUSTOMER PARTNERSHIPS

Pharmaceutical and agricultural chemical companies typically have longer new product development cycles than

companies in other industries because of the extensive regulatory approvals required prior to market introduction. These companies rely on ISP as a partner in their development cycle, enabling them to expedite the process while developing formulations that meet ever more stringent market and regulatory demands.

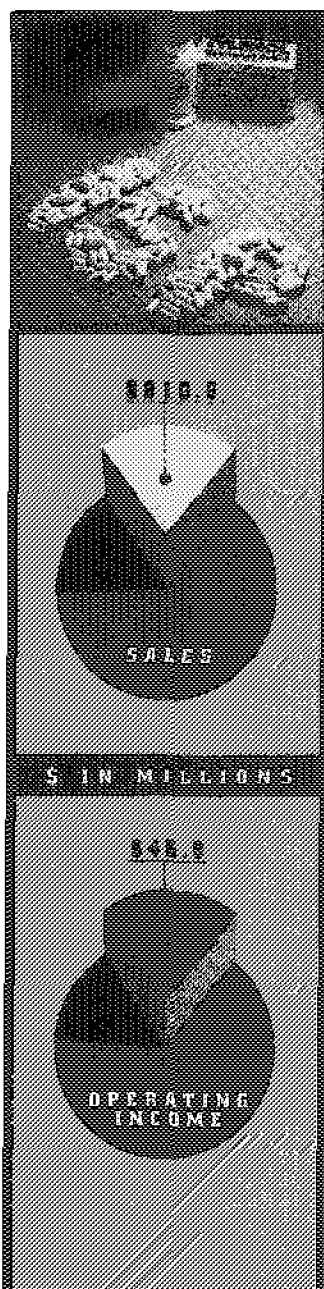
Last year, ISP established new partnerships with a number of key customers. Highly focused, multifunctional teams with representatives from ISP and its customers are identifying opportunities for improvements in both new and existing products. For example, after an exchange of proprietary technology with a major customer, one team's efforts recently resulted in ISP developing for this customer a new copolymer to be incorporated into their anti-bacterial product planned for release in 1999.

OPERATIONAL EXCELLENCE

ISP restructured its Beverage and Pharmaceutical sales forces in 1998 to better focus on these two key markets. In addition, a new Global Beverage Services Group was established last year with the capability to provide complete customer service. Highly specialized ISP scientists and brew-masters, using advanced analytical techniques to optimize stabilization regimes, now provide in-depth technical service anywhere in the world. ISP's ability to work inside the brewery directly with the customer is expected to bolster sales, particularly in emerging Asian and Latin American markets. Similarly, ISP's Pharmaceutical sales force is currently identifying new opportunities for ISP's excipients in several rapidly developing markets.

FINANCIAL PERFORMANCE

The Pharmaceutical, Agricultural and Beverage business segment, representing 26% of ISP's 1998 sales, recorded revenues of \$210.6 million, roughly flat with 1997 revenues of \$208.4 million. Improved pricing and increased unit volumes in areas other than Asia were largely offset by lower sales in that region of the world. Operating income was \$45.8 million in 1998 compared with \$46.6 million in 1997.



PERFORMANCE CHEMICALS FINE CHEMICALS AND INDUSTRIAL

ISP's Performance Chemicals business manufactures acetylene-based polymers, vinyl ethers, and advanced materials for specialty industrial applications. These performance polymers are used in a wide range of applications, such as detergents, coatings, adhesives, imaging, electronics and metalworking.

ISP's Fine Chemicals business manufactures a variety of highly specialized products sold to the pharmaceutical, biotechnology, agricultural and imaging markets. In addition, the business offers custom manufacturing services at both its Columbus, Ohio and Freetown, Massachusetts facilities. ISP's Columbus facility specializes in the production of chiral compounds for the pharmaceutical market, and by virtue of its recently expanded cryogenic manufacturing capability, ISP continues to be a leading innovator in large scale, cold temperature manufacturing under cGMP conditions. In addition to custom manufactured pharmaceutical products, ISP's Freetown facility, acquired last year from Polaroid Corporation, is also well suited for the large-scale manufacturing of fine chemical products requiring state-of-the-art precision. Pursuant to a multi-year supply agreement, this facility also produces imaging chemicals and polymers for Polaroid's instant film products.

ISP's Industrial business manufactures intermediate and solvent products including butanediol, tetrahydrofuran (THF), *N*-methyl pyrrolidone (M-PYROL®), γ -Butyrolactone (BLO®), and *N*-vinyl pyrrolidone (V-PYROL®). These products serve as intermediates for ISP's downstream polymers business, including products sold by ISP's Hair Care, Pharmaceutical, Agricultural, Beverage and Performance Chemicals businesses, and are sold in the merchant market for use in the manufacture of such diverse products as engineered plastics, lubricating oil, electronic components, cleaning and coatings formulations. In addition, the Company offers a family of

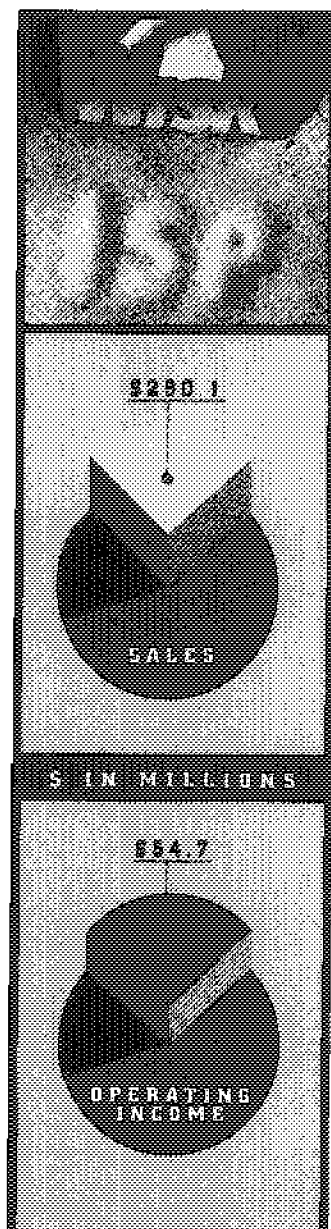
environmentally friendly products that replace chlorinated and other volatile solvents for use in cleaning, stripping and degreasing applications.

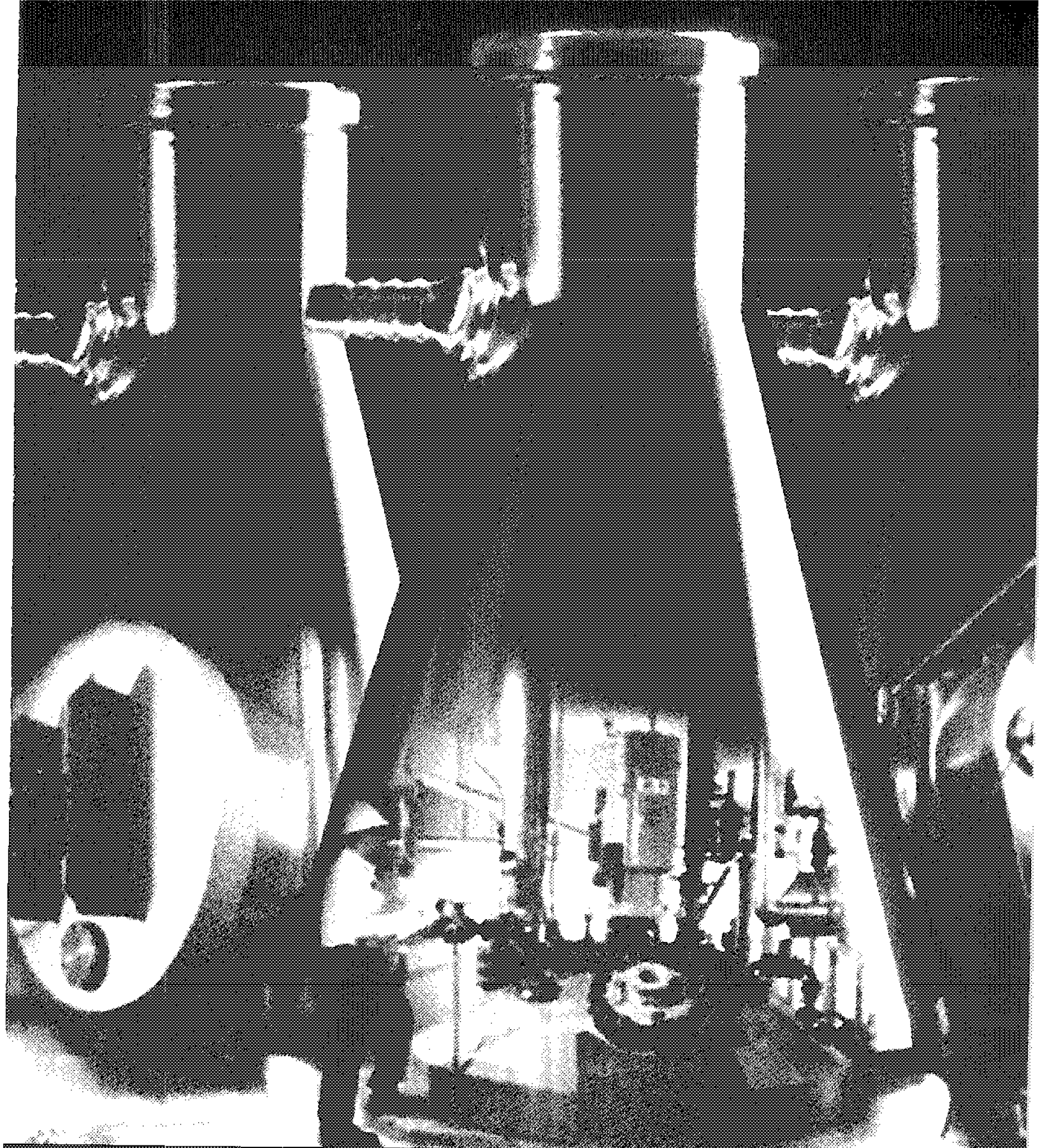
INNOVATION

Last year, ISP's Performance Chemicals business commercialized a number of new products in several markets. In the oilfield chemicals market, ISP entered into a joint development program with a major oil producer for the continued development of ISP's gas hydrate inhibitor (GHI) polymer systems for oilfield applications. These GHI polymer systems prevent the build-up of ice crystals in gas processing lines, thereby reducing the cost of operating a natural gas processing facility. One of ISP's GHI polymer systems has recently been qualified in two North Sea oilfields, while two other programs are underway to develop GHI polymer systems for Latin America and the Gulf Coast.

CUSTOMER PARTNERSHIPS

ISP's Performance Chemicals business was actively involved this past year, in conjunction with several major customers, in the development of the next generation of specialty polymers for the high growth, consumer detergent market. ISP offers unique polymers that provide detergents with their color-safe properties. ISP completed the development of its new CHROMABOND™ polymer, an innovative dye transfer inhibitor for color-safe laundry detergent brands, to complement its market-leading polyvinyl pyrrolidone based (PVP) line of dye transfer inhibitors. Because of its higher efficacy at lower usage levels, CHROMABOND™ is a very cost-effective system for complexing fugitive dyes and preventing re-deposition during the wash cycle of mixed color fabrics. CHROMABOND™ was developed in partnership with a leading household detergent company and will be formulated into a major European brand in 1999.





PERFORMANCE CHEMICALS, FINE CHEMICALS AND INDUSTRIAL

PERFORMANCE CHEMICALS FINE CHEMICALS AND INDUSTRIAL

ISP's Fine Chemicals business has entered into a number of development and manufacturing programs with several major pharmaceutical companies for the development and manufacture of proprietary pharmaceutical intermediates. As these products come to market, they are expected to significantly contribute to the continued growth of the Fine Chemicals business.

OPERATIONAL EXCELLENCE

ISP's Industrial business undertook two initiatives this past year which have resulted in reducing the Company's manufacturing cost for butanediol, while assuring its long-term supply of this critical raw material:

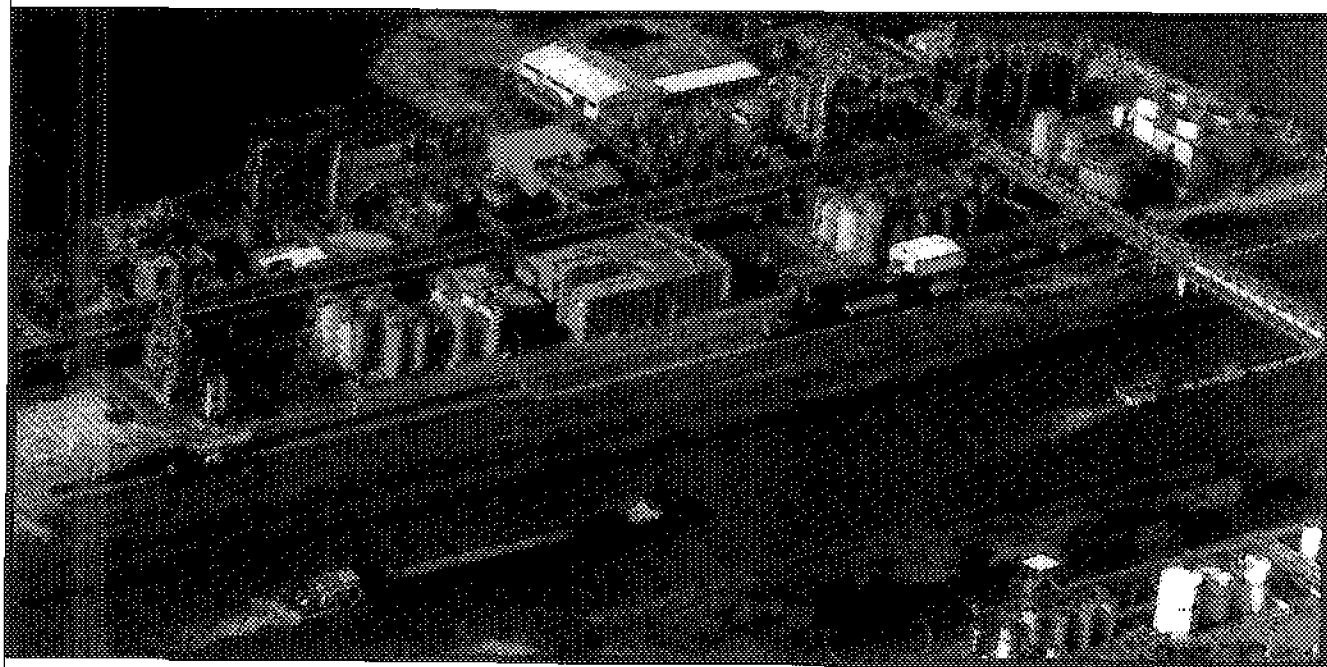
(1) The Company purchased the remaining 50% of GAP-Hüls Chemie GmbH (GhC), its joint venture with Hüls AG, effective April 1, 1998. GhC consists of a modern, state-of-the-art manufacturing facility that primarily produces butanediol and tetrahydrofuran. As part of the transaction, the Company also acquired the fully dedicated, modern production facility that provides the Marl, Germany, plant with its primary raw material, acetylene; and

(2) In December 1998, ISP announced that it would close its butanediol production unit in Calvert City, Kentucky, and replace that plant's butanediol requirements with lower cost material produced at GhC.

The acquisition of the remaining 50% interest in GhC's butanediol capacity, combined with the shut down of the Calvert City butanediol assets, has allowed the Company to achieve a meaningful reduction in the average unit cost of butanediol when compared with 1997. This lower cost position enables ISP to more effectively compete in global markets for butanediol, while reducing the manufacturing cost of its downstream polymers.

FINANCIAL PERFORMANCE

Revenues for the Performance Chemicals, Fine Chemicals and Industrial business segment, representing 35% of total ISP revenues, increased 26% to \$290.1 million in 1998, principally as a result of strong growth in the Fine Chemicals business and the acquisition of the remaining 50% of GhC. Operating profit for the year, before a one-time charge of \$70 million for the write-down of the Company's butanediol production assets, was \$54.7 million, compared with \$31.9 million in 1997.



ISP's facility in Marl, Germany

MINERAL PRODUCTS



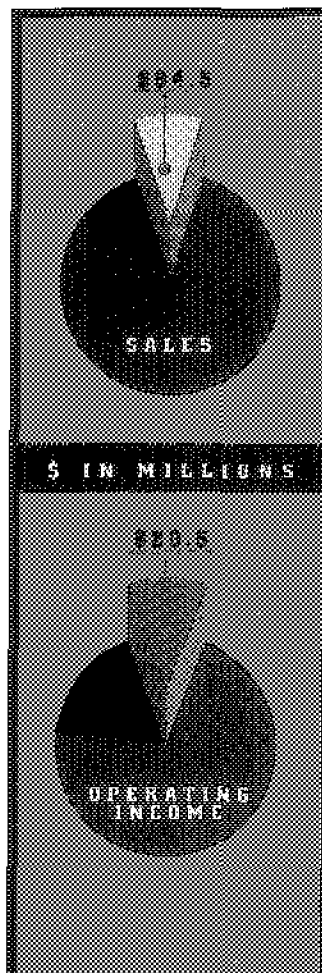
ISP's Mineral Products business segment manufactures ceramic-coated colored granules sold to the roofing industry. These granules greatly improve the weather resistance and aesthetic appeal of both standard and premium-grade asphalt roofing shingles. ISP's established reputation for excellent service and product quality, combined with continuing research and development efforts to improve the performance characteristics of the Company's products, solidifies ISP's position as a leading supplier to the North American asphalt roofing shingle market.

ISP utilizes a proprietary ceramic-coating process to color its roofing granules, which are produced from unique rock deposits that are mined and crushed at the Company's three quarries. A recent research

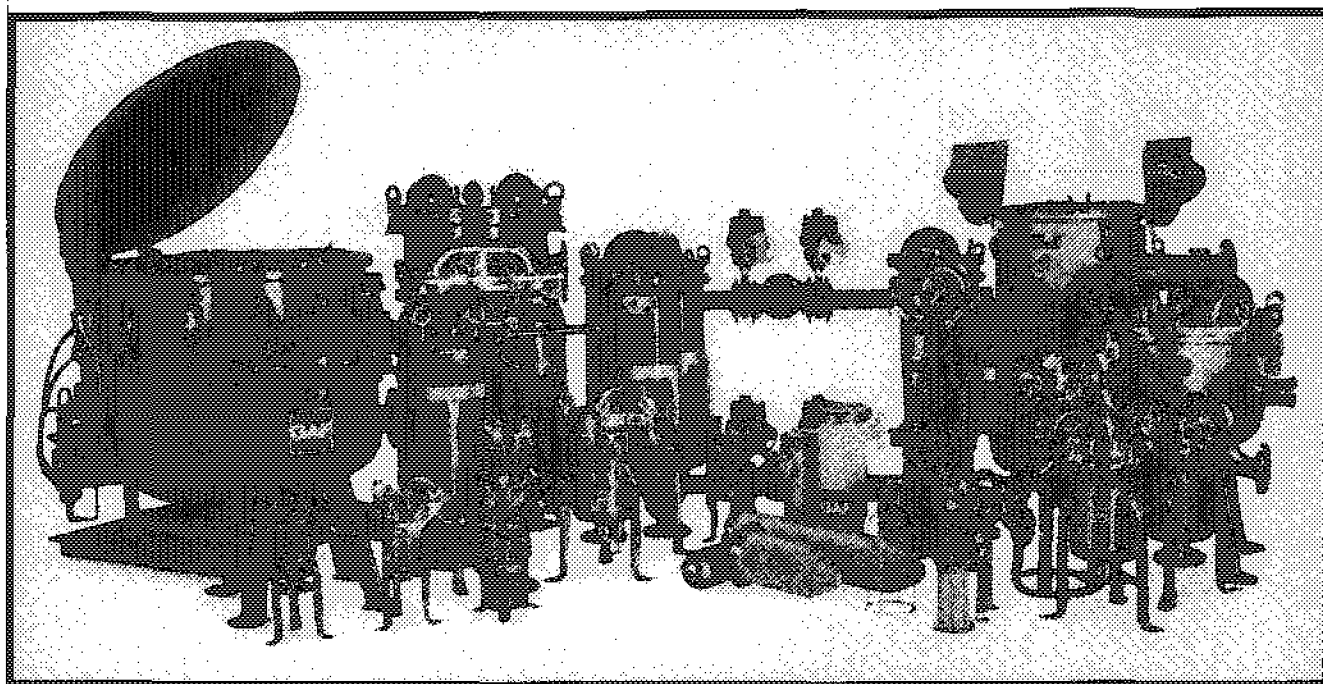
and development program led to the introduction of a new line of algae-resistant granules suitable for humid or shaded environments. These durable, ceramic-covered minerals provide the beauty and protection needed to assure lasting performance and homeowner peace-of-mind.

FINANCIAL PERFORMANCE

ISP's Mineral Products business segment, which represented 11.5% of the Company's total revenues in 1998, reported revenues of \$94.5 million, an increase of 14% over 1997 revenues of \$83.1 million. Operating income increased 20% to \$20.5 million, compared with \$17.0 million reported in 1997. Mineral Products divested its Tennis Court Materials business in September 1998.



FILTER PRODUCTS



ISP manufactures a complete line of filter systems for use in the macroscopic filtration of process liquids. Serving primarily the chemical, paint, automotive, pharmaceutical, petroleum, municipal water, and food and beverage industries, ISP is a leading global supplier of pressure-rated bag filtration equipment. The Company's product line includes standard and custom filter vessels, filter bags and accessories.

INNOVATION

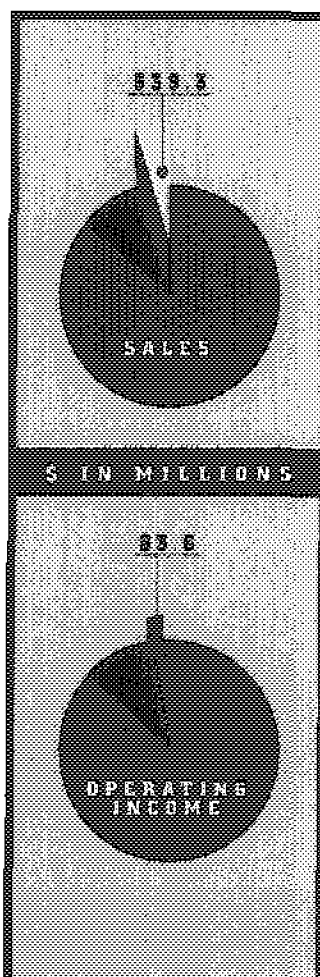
The Company has long been an innovator in the industry and remains the market leader in Europe, Latin America, Japan and Australia. Recent innovations include the development of the AccuGAF[™] and ProGAF[™] filter bags for use in specific pharmaceutical and food and beverage applications. Each of these products is designed to accommodate higher flow rates while achieving better filtration efficiencies than equivalently-rated cartridges. Both are constructed using the new Uni-Weld[™] process. This unique, single-step welding

operation provides a stronger, more consistent weld seam in the filter bag which allows the bag to fit more effectively in the filter vessel and protects the bag from failing due to process disruptions.

ISP operates manufacturing, marketing and sales locations worldwide. In addition, a research and development laboratory located in Sint-Niklaas, Belgium, supports the global sales force and associated customer and technical service representatives. This network of application development specialists allows ISP to continue to focus on developing high value-added applications for key customers.

FINANCIAL PERFORMANCE

ISP's Filter Products revenues, which represented 5% of the Company's total revenues, were \$39.3 million in 1998, down from \$40.3 million in 1997. Operating income in 1998 was \$3.6 million, flat with 1997 operating income.



SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1998

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 333-17827

INTERNATIONAL SPECIALTY PRODUCTS INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

51-0376469
(I.R.S. Employer Identification No.)

818 Washington Street
Wilmington, Delaware
(Address of Principal Executive Offices)

19801
(Zip Code)

Registrant's telephone number, including area code:

(302) 428-0847

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, par value \$.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

As of March 19, 1999, 68,686,406 shares of common stock of the registrant were outstanding. The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 19, 1999 was \$122,533,408. The aggregate market value was computed by reference to the closing price on the New York Stock Exchange of common stock of the registrant on such date (\$8.00). For purposes of the computation, voting stock held by executive officers and directors of the registrant has been excluded. Such exclusion is not intended, and shall not be deemed, to be an admission that such executive officers and directors are affiliates of the registrant.

Documents Incorporated by Reference

The Proxy Statement for the 1999 Annual Meeting of Stockholders of International Specialty Products Inc. to be filed within 120 days after the registrant's fiscal year-end (the "Proxy Statement") is incorporated by reference in Part III, Items 10, 11, 12 and 13.

PART I

Item 1. *Business*

General

International Specialty Products Inc. (formerly ISP Holdings Inc.) ("ISP") is a leading multinational manufacturer of specialty chemicals, mineral products and filter products.

We operate our business exclusively through our direct and indirect subsidiaries, including ISP Opco Holdings Inc., ISP Chemicals Inc., ISP Technologies Inc., ISP Van Dyk Inc., ISP Fine Chemicals Inc. and ISP Freetown Fine Chemicals Inc. We were incorporated in Delaware in 1996.

On July 15, 1998, International Specialty Products Inc. ("Old ISP") merged with and into our company (then known as ISP Holdings Inc. ("ISP Holdings")). In connection with the merger, each share of common stock of Old ISP (other than those held by ISP Holdings) was automatically converted into one share of common stock of the surviving corporation, substantially all of the assets and liabilities of Old ISP were transferred to our subsidiary, ISP Opco Holdings Inc., and we changed our name to International Specialty Products Inc. Approximately 76% of our outstanding common stock is owned beneficially (as defined in Rule 13d-3 of the Securities Exchange Act of 1934) by Samuel J. Heyman, our Chairman of the Board of Directors and Chief Executive Officer.

Prior to January 1, 1997, ISP Holdings was a wholly-owned subsidiary of GAF Corporation. On January 1, 1997, GAF effected a series of transactions involving its subsidiaries that resulted in, among other things, the capital stock of ISP Holdings being distributed to the stockholders of GAF. As a result of this distribution, we are no longer a subsidiary of GAF, and the assets and liabilities of other wholly-owned subsidiaries of GAF, including G-I Holdings Inc., Building Materials Corporation of America, U.S. Intec, Inc. and GAF Fiberglass Corporation, are no longer included in our assets and liabilities.

The address and telephone number of our principal executive offices are 818 Washington Street, Wilmington, Delaware 19801, (302) 428-0847.

Financial information concerning our industry segments and foreign and domestic operations required by Item 1 is included in Notes 13 and 14 to Consolidated Financial Statements contained in this Annual Report on Form 10-K.

Specialty Chemicals

Products and Markets. We manufacture a broad spectrum of specialty chemicals having numerous applications in consumer and industrial products. We use proprietary technology to convert various raw materials, through a chain of one or more processing steps, into increasingly complex and higher value-added specialty chemicals specifically developed to meet customer requirements.

Our specialty chemicals business is organized based upon the markets for our products. Accordingly, we manage our specialty chemicals in the following three business segments:

- Personal Care—whose products are sold to the skin care and hair care markets;
- Pharmaceutical, Agricultural and Beverage—whose products are sold to these three government-regulated industries; and
- Performance Chemicals, Fine Chemicals and Industrial—whose products are sold to numerous consumer and industrial markets.

For the year ended December 31, 1998, sales of specialty chemicals represented approximately 84% of our revenues. Most of our specialty chemical products fall within the following categories:

- *vinyl ether monomers*—includes several products for use in specialty and radiation-cured coatings. Our vinyl ether monomers are marketed by our Performance Chemicals group of our Performance Chemicals, Fine Chemicals and Industrial business segment.

- *vinyl ether copolymers*—includes our GANTREZ® line of products. These products serve as a bioadhesive resin in such consumer products as tartar-control toothpaste, denture adhesives and facial pore strips. Vinyl ether copolymers are marketed by the Personal Care and Pharmaceutical, Agricultural and Beverage business segments.
- *polyvinyl pyrrolidone (PVP) polymers and copolymers*—represents our largest product group. These polymers and copolymers are marketed by all of our business segments. Our PLASDONE®, POLYCLAR® and GAFQUAT® product lines, which are used as tablet binders, beverage clarifiers and hair fixative resins, respectively, are included in this group.
- *intermediates*—includes butanediol, butenediol, butynediol and propargyl alcohol for use in numerous industrial applications. Intermediates are marketed by our Performance Chemicals, Fine Chemicals and Industrial business segment. Our largest selling intermediate product is butanediol, which is utilized by industrial companies to manufacture spandex fibers and polybutylene terephthalate (PBT) plastics for use in automobiles.
- *solvents*—includes our M-PYROL® brand of *N*-methyl pyrrolidone (NMP), for use in metal degreasing and paint stripping, BLO® brand of *gamma*-butyrolactone, for use by electronics companies in the manufacture of semiconductors and micro-processing chips, and tetrahydrofuran (THF), which is used in the manufacture and installation of PVC pipe. Solvents are also marketed by our Performance Chemicals, Fine Chemicals and Industrial business segment.

The balance of our specialty chemical products include fine chemicals, sunscreens, preservatives, emollients and advanced materials. These products are marketed by all of our business segments.

Personal Care. Our Personal Care business segment markets numerous specialty chemicals that serve as critical ingredients in the formulation of many well-known skin care, hair care, toiletry and cosmetic products.

Our skin care ingredients include:

- ultraviolet (UV) light absorbing chemicals, which serve as sunscreens;
- emollients, which provide skin softness;
- moisturizers, which enhance the skin's water balance;
- waterproofing agents, which enhance the performance of eye-liners and sunscreens in wet environments; and
- preservatives, which extend the shelf life of aqueous-based cosmetic formulations by preventing the growth of harmful bacteria.

Our ESCALOL® sunscreen actives serve as the primary active ingredient in many of the most popular sunscreens today and increasingly find applications in many other products such as lipsticks and facial creams. Our CERAPHYL® line of emollients and moisturizers provides a variety of popular bath products with their softening and moisturizing characteristics. We produce a growing number of specialty preservatives, including GERMALL® PLUS, a patented product that offers broad-spectrum anti-microbial activity, and SUTTOCIDE® A, a preservative gentle enough for infant care products.

Our hair care ingredients, marketed under the GANTREZ®, GAFQUAT® and PVP/VA family of products, include a number of specially formulated fixative resins which provide hairsprays, mousses and gels with their holding power, as well as thickeners and stabilizers for shampoos and conditioners. Utilizing our combined expertise in hair care and sunscreen applications, we recently developed the world's first high performance hair protectant, ESCALOL® HP-610, to prevent sun damage to hair.

Pharmaceutical, Agricultural and Beverage. Our specialty chemicals for the Pharmaceutical, Agricultural and Beverage markets provide a number of end-use products with their unique properties, while enabling these products to meet increasingly strict regulatory requirements.

In the pharmaceutical market, our specialty chemicals serve as key ingredients in the following types of products:

- prescription and over-the-counter tablets;
- injectable prescription drugs and serums;
- cough syrups;
- antiseptics;
- toothpastes; and
- denture adhesives.

Our PLASDONE® and POLYPLASDONE® polymers for tablet binders and tablet disintegrants are established excipients for use in the production of wet granulated tablets, and our GANTREZ® bioadhesive polymers serve as critical ingredients in denture adhesives and tartar control toothpastes.

We believe that we are a leading producer of inert ingredients for the agricultural industry, where our solvents and polymers are used for the formulation of safer and more effective crop treatment products. For example, our AGRIMER® line of specialty polymers are EPA-approved inert ingredients which are used in seed-coating, crop dusting products and as binders and disintegrants for a variety of pesticide tablets, pellets and granules.

Our specialty polymers, marketed under the POLYCLAR® trade name, serve the beverage market by assuring the clarity and extending the shelf life of beer, wine and fruit juices.

Performance Chemicals, Fine Chemicals and Industrial. Our Performance Chemicals business includes acetylene-based polymers, vinyl ether monomers and advanced materials for industrial applications. Our acetylene-based chemistry produces a number of performance polymers for use in a wide range of industrial markets including:

- coatings;
- adhesives;
- imaging;
- detergents;
- electronics; and
- metalworking.

Our advanced materials consist of high-purity carbonyl iron powders, sold under the MICROPOWDER® name, for use in the aerospace, defense, electronics and powder metallurgy industries.

Our Fine Chemicals business focuses on the production of a variety of highly specialized products sold to the pharmaceutical, biotechnology, agricultural and imaging markets. We also offer custom manufacturing services for these industries.

We manufacture a broad range of fine chemicals under U.S. FDA current good manufacturing practices (cGMP) at our Columbus, Ohio facility. These fine chemicals include:

- bulk pharmaceuticals, such as flunixin meglumine, a veterinary drug, and mitotane, a cancer treatment drug;
- pharmaceutical intermediates, manufactured under contract for well-known pharmaceutical companies whose end products treat heart and kidney diseases, viral infections, and lower cholesterol; and
- pheromones, for use in insect population measurement and control.

We expanded our presence in the fine chemicals market in February 1998 with the acquisition of a manufacturing facility in Freetown, Massachusetts from Polaroid Corporation. We currently plan to expand the production capability at this facility to include the manufacture of certain specialty chemical product lines for our Personal Care business segment and to offer custom manufacturing capability to the pharmaceutical, biotechnology, agricultural and chemical process industries. As part of the acquisition, we entered into a multi-year agreement to supply the imaging dyes and polymers used by Polaroid in its instant film business.

In our Industrial business, we market several intermediate and solvent products, such as butanediol, tetrahydrofuran (THF) and *N*-methyl pyrrolidone (NMP), for use in a variety of industries, including:

- high performance plastics;
- lubricating oil and chemical processing;
- electronics cleaning; and
- coatings.

In addition, we offer a family of environmentally friendly products that can replace chlorinated and other volatile solvents for a variety of industrial uses, including cleaning, stripping and degreasing.

Effective April 1, 1998, we acquired the remaining 50% interest in GAF-Hüls Chemie GmbH ("GhC"), our joint venture with a subsidiary of Hüls AG, that is based in Marl, Germany. As part of the transaction, we also acquired from Hüls the fully-dedicated, modern production facility that provides GhC with its primary raw material, acetylene. We believe that the production costs for butanediol and THF at GhC are among the most competitive in the industry. We believe that this acquisition will contribute significantly toward our goal of continued future access to a low-cost supply of butanediol.

Based on a review of our entire butanediol manufacturing network, which includes the Texas City, Texas; Calvert City, Kentucky; and Marl, Germany plants, we announced in January 1999 that we intend to shut down the production unit for butanediol at our Calvert City plant.

Marketing and Sales. We market our specialty chemicals using a worldwide marketing and sales force, typically chemists or chemical engineers, who work closely with our customers to familiarize themselves with our customers' products, manufacturing processes and markets. We conduct our domestic marketing and sales efforts from our facility in Wayne, New Jersey and regional offices strategically located throughout the United States.

International Operations. We conduct our international operations through 39 subsidiaries and 42 sales offices located in Europe, Canada, Latin America and the Asia-Pacific region. We also use the services of local distributors to reach markets that might otherwise be unavailable to us.

International sales of our specialty chemicals in 1998 were approximately 46% of our total sales for the year. Approximately 38% of our specialty chemicals sales in 1998 were in Europe and Japan. Sales in these regions are subject to exchange rate fluctuation risks. For a discussion of our policy regarding the management of these risks, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Financial Condition." Other countries in which we have sales are subject to additional risks, including high rates of inflation, exchange controls, government expropriation and general instability.

We own and operate GhC, primarily a butanediol manufacturing facility, and ISP Acetylene GmbH, an acetylene production plant. Both production facilities are located at Hüls' Chemiepark site in Marl, Germany, and each relies upon Hüls to provide certain services, including utilities, rail transport and waste handling. GhC is the most modern butanediol production facility in our butanediol manufacturing network. ISP Acetylene, which employs electric arc technology for the production of acetylene from various hydrocarbon feedstocks, was built in 1992 to replace an older facility and utilizes state-of-the-art gas separation technology. ISP Acetylene's entire production is dedicated to fulfilling GhC's requirements and has no third-party sales.

Raw Materials. Because of the multi-step processes required to manufacture our specialty chemicals, we believe that our raw materials costs represent a smaller percentage of the cost of goods sold than for most other chemical companies. We estimate that approximately one-third of our manufacturing costs are for raw materials (including energy and packaging). As a result, we believe that fluctuations in the price of raw materials have less of an impact on our specialty chemicals business than on those chemical companies for which raw materials costs represent a larger percentage of manufacturing costs.

The principal raw materials used in the manufacture of our specialty chemicals are acetylene, methanol and methylamine. Most of the raw materials for consumption in the United States are obtained from third party sources pursuant to supply agreements. Acetylene, a significant raw material used in the production of most of our specialty chemicals, is obtained by us for domestic use from two unaffiliated suppliers pursuant to supply contracts. At our Texas City and Seadrift, Texas plants, acetylene is supplied via pipeline by a neighboring large multinational company that generates this raw material as a by-product from the manufacture of ethylene. At our Calvert City, Kentucky facility, acetylene is supplied via pipeline by a neighboring company that generates it from calcium carbide.

Due to the nature of the manufacturing process, electricity and hydrocarbon feedstocks (primarily butane) are critical raw materials for the production of acetylene at our operations in Marl, Germany, where methanol is also a principal raw material. Electricity, butane and methanol for Marl, Germany are supplied to us by Hüls pursuant to a long-term supply agreement.

We believe that the diversity of our acetylene supply sources and our use of a number of acetylene production technologies (ethylene by-product, calcium carbide and electric arc technology) provide us with a reliable supply of acetylene. In the event of a substantial interruption in the supply of acetylene from current sources, or, in the case of GhC, electricity and hydrocarbon feedstocks, we cannot assure that we would be able to obtain as much acetylene from other sources as would be necessary to meet our supply requirements. To date, we have not experienced an interruption of our acetylene supply that has had a material adverse effect on our sales of specialty chemicals.

Availability of other raw materials, including methanol and methylamine, remained adequate during 1998. We believe that, in the event of a supply interruption, we could obtain adequate supplies of such raw materials from alternate sources.

We use natural gas and raw materials derived from petroleum in many of our manufacturing processes and, consequently, the price and availability of natural gas and petroleum could be material to our operations. During 1998, crude oil and natural gas supplies remained adequate, while prices generally demonstrated seasonal variations.

Mineral Products

Products and Markets. We manufacture mineral products consisting of ceramic-coated colored roofing granules, which are produced from rock deposits that are mined and crushed at our quarries and are colored and coated using a proprietary process. We sell our mineral roofing granules primarily to the North American roofing industry for use in the manufacture of asphalt roofing shingles. The granules help to provide weather resistance, decorative coloring, heat deflection and increased weight in the shingle. We are the second largest of only three major suppliers of colored roofing granules in North America.

We estimate that more than 80% of the asphalt shingles currently produced by the roofing industry are sold for the reroofing/replacement market, in which demand is driven not by the pace of new home construction but by the needs of homeowners to replace existing roofs. Homeowners generally replace their roofs either because they are worn, thereby creating concerns as to weather-tightness, or because of the homeowners' desire to upgrade the appearance of their homes. We estimate that the balance of the roofing industry's asphalt shingle production historically has been sold primarily for use in new housing construction. Sales of our colored mineral granules have benefited from a trend toward the increased use of heavyweight, three-dimensional laminated roofing shingles which results in both functional and aesthetic improvements. These shingles require, on average, approximately 60% more granules than traditional three-tab, lightweight roofing shingles.

Sales to Building Materials Corporation of America ("BMCA"), one of our affiliates, and its subsidiaries constituted approximately 66% of our mineral products net sales in 1998. See Item 13, "Certain Relationships and Related Transactions" and Note 12 to Consolidated Financial Statements.

Raw Materials. We own rock deposits that have specific performance characteristics, including weatherability, the ability to reflect UV light, abrasion-resistance, non-staining characteristics and the ability to absorb pigments. We own three quarries, each with proven reserves, based on current production levels, of more than 20 years.

Filter Products

We manufacture and sell filter products, consisting of pressure filter vessels, filter bags and filter systems. These filter products are designed for the removal of macroscopic contaminants in the treatment of process liquids. The paint, automotive, chemical, pharmaceutical, petroleum and food and beverage industries accounted for almost all of our 1998 net sales of filter products.

We manufacture pressure filter vessels at manufacturing facilities in Brazil, Canada and Germany, which serve both local and international markets. We also manufacture filter bags in Belgium, Canada, Singapore, Brazil and the United States and supply filter products worldwide through our subsidiaries, sales offices and distributors.

Competition

We believe that we are either the first or second largest seller worldwide of our specialty chemicals derived from acetylene, other than butanediol and tetrahydrofuran.

In each end-use market, there are a limited number of companies that produce substitutable products for our acetylene-derived specialty chemicals. These companies compete with us in the personal care, pharmaceutical, beverage and industrial markets and have the effect of limiting our market penetration and pricing flexibility. For our specialty chemicals not derived from acetylene, including sunscreens, emollients, moisturizers and fine chemicals, a number of world-wide competitors can provide similar products or services. We compete on quality, price and customer service in these markets.

Butanediol, which we produce primarily for use as a raw material, is also manufactured by a limited number of companies throughout the world for both their captive use or to supply the merchant market. We believe that there are three competitors of significance for merchant market butanediol. One of these competitors sources the merchant market from its plants in the United States and Europe. The two other competitors each source the merchant market from their single manufacturing plants, one in the United States and the other in Europe. Recently, a fourth competitor announced its intention to enter the merchant butanediol market and began construction of a plant in the United States. Tetrahydrofuran is manufactured by a number of companies throughout the world.

With regard to our mineral products, we have only one major and one smaller competitor and believe that competition has been limited by:

- the substantial capital expenditures associated with the construction of new mineral processing and coloring plants and the acquisition of suitable rock reserves;
- the limited availability of proven rock sources;
- the complexity associated with the construction of a mineral processing and coloring plant, together with the technical know-how required to operate such a plant;
- the need to obtain, prior to commencing operations, reliable data over a substantial period of time regarding the weathering of granules in order to assure the quality and durability of the product; and
- the difficulty in obtaining the necessary permits to mine and operate a quarry.

With respect to filter products, we compete with a number of companies worldwide.

Competition is largely based upon product and service quality, technology, distribution capability and price. We believe that we are well-positioned in the marketplace as a result of our broad product lines, sophisticated technology and worldwide distribution network.

Research and Development

Our worldwide research and development expenditures were \$25.4 million, \$27.3 million, and \$26.3 million in 1996, 1997 and 1998, respectively.

Our research and development activities are conducted primarily at our worldwide technical center and laboratories in Wayne, New Jersey. Additional research and development is conducted at plant sites in Calvert City, Kentucky; Texas City, Texas; Chatham, New Jersey; Belleville, New Jersey; Freetown, Massachusetts; and Columbus, Ohio and technical centers in the United Kingdom, Belgium, Germany, China and Singapore. Our mineral products research and development facility, together with our customer design and color center, is located at Hagerstown, Maryland. Our filter products research and development is conducted at our Belgium facility.

Environmental Services

We have received site designation for the construction of a hazardous waste treatment, storage and disposal facility at our Linden, New Jersey property and have received approval from the New Jersey Turnpike Authority for a direct access ramp from the New Jersey Turnpike to the site. If we are successful in securing the necessary permits to construct and operate the hazardous waste facility, we intend to develop and operate the facility in a separate subsidiary, either on our own or in a joint venture with a suitable partner. We estimate that the cost of constructing the facility will be approximately \$100 million and, if approved, the facility is anticipated to be in operation three years after commencement of construction. We anticipate utilizing internally generated cash and/or seeking project or other independent financing for this project. We also are investigating additional development opportunities at this site.

Patents and Trademarks

As of December 31, 1998, we owned or licensed approximately 360 domestic and 370 foreign patents or patent applications and owned or licensed approximately 140 domestic and 1,390 foreign trademark registrations or applications related to our business. While we believe the patent protection covering certain of our products is material to those products, we do not believe that any single patent, patent application or trademark is material to our business or operations. We believe that the duration of the existing patents and patent licenses is consistent with our business needs.

Environmental Compliance

Since 1970, a wide variety of federal, state and local environmental laws and regulations relating to environmental matters have been adopted and amended. By reason of the nature of our operations and the operations of our predecessor and certain of the substances that are or have been used, produced or discharged at our or its plants or at other locations, we are affected by these environmental laws and regulations. We have made capital expenditures of less than \$4.0 million in each of the three years ended December 31, 1998, in order to comply with these laws and regulations. These expenditures are included in additions to property, plant and equipment. We anticipate that aggregate capital expenditures relating to environmental compliance in each of 1999 and 2000 will be approximately \$4.0 million.

The environmental laws and regulations deal with air and water emissions or discharges into the environment, as well as the generation, storage, treatment, transportation and disposal of solid and hazardous waste, and the remediation of any releases of hazardous substances and materials to the environment. We believe that our manufacturing facilities comply in all material respects with applicable environmental laws and regulations, and, while we cannot predict whether more burdensome requirements will be adopted in the future, we believe that any potential liability for compliance with environmental laws and regulations will not materially affect our business, liquidity, results of operations, cash flows or financial position.

We believe that we operate our manufacturing facilities in compliance in all material respects with applicable environmental, health and safety laws and regulations, but we cannot predict whether more burdensome requirements will be imposed by governmental authorities in the future.

Employees

At December 31, 1998, we employed approximately 2,900 people worldwide. Approximately 750 employees in the United States were subject to five union contracts. We believe that our relations with our employees and their unions are satisfactory.

Item 2. Properties

Our corporate headquarters and principal research and development laboratories are located at a 100-acre campus-like office and research park owned by one of our subsidiaries at 1361 Alps Road, Wayne, New Jersey 07470. The premises are subject to a first mortgage.

The principal domestic and foreign real properties either owned by, or leased to, us are described below. Unless otherwise indicated, the properties are owned in fee. In addition to the principal facilities listed below, we maintain sales offices and warehouses in the United States and abroad, substantially all of which are in leased premises under relatively short-term leases.

<u>Location</u>	<u>Facility</u>	<u>Product Line</u>
	Domestic	
Alabama		
Huntsville	Plant*	Specialty Chemicals
Kentucky		
Calvert City	Plant	Specialty Chemicals
Maryland		
Hagerstown	Research Center, Design Center, Sales Office	Mineral Products
Massachusetts		
Freetown	Plant, Research Center	Specialty Chemicals
Missouri		
Annapolis	Plant, Quarry	Mineral Products
New Jersey		
Belleville	Plant, Sales Office, Research Center, Warehouse	Specialty Chemicals
Bridgewater	Sales Office	Specialty Chemicals
Chatham	Plant, Sales Office, Research Center	Specialty Chemicals
Wayne	Headquarters, Corporate Administrative Offices, Research Center	Specialty Chemicals
Ohio		
Columbus	Plant, Research Center, Sales Office	Specialty Chemicals
Pennsylvania		
Blue Ridge Summit	Plant, Quarry	Mineral Products
Tennessee		
Memphis	Plant*, Warehouse*, Distribution Center*	Filter Products
Texas		
Seadrift	Plant	Specialty Chemicals
Texas City	Plant	Specialty Chemicals
Wisconsin		
Pembine	Plant, Quarry	Mineral Products

<u>Location</u>	<u>Facility</u>	<u>Product Line</u>
International		
Belgium		
Sint-Niklaas	Plant, Sales Office, Research Center, Distribution Center	Specialty Chemicals and Filter Products
Brazil		
Sao Paulo	Plant*, Sales Office*, Distribution Center*	Specialty Chemicals and Filter Products
Canada		
Mississauga, Ontario	Sales Office*, Distribution Center*	Specialty Chemicals
Oakville, Ontario	Plant*	Filter Products
Germany		
Cologne	Research Center*, Sales Office*	Specialty Chemicals
Hamburg	Plant*	Filter Products
Marl	Plants**, Sales Office**	Specialty Chemicals
India		
Nagpur	Plant**	Specialty Chemicals
Japan		
Tokyo	Sales Office*	Specialty Chemicals and Filter Products
Singapore	Plant*, Sales Office*, Distribution Center*, Asia-Pacific Headquarters*, Warehouse*	Specialty Chemicals and Filter Products
United Kingdom		
Guildford	European Headquarters*, Research Center*	Specialty Chemicals
Manchester	Sales Office**, Distribution Center**	Specialty Chemicals and Filter Products

* Leased property

** Long-term ground lease

We believe that our plants and facilities, which are of varying ages and are of different construction types, have been satisfactorily maintained, are in good condition, are suitable for their respective operations and generally provide sufficient capacity to meet production requirements. Each plant has adequate transportation facilities for both raw materials and finished products. In 1998, we made capital expenditures of \$83.6 million relating to plant, property and equipment.

Item 3. Legal Proceedings

Our company, together with other companies, is a party to a variety of proceedings and lawsuits involving environmental matters ("Environmental Claims") under the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA") and similar state laws, in which recovery is sought for the cost of cleanup of contaminated sites, a number of which are in the early stages or have been dormant for protracted periods.

We estimate that our liability in respect of all Environmental Claims (including those relating to our closed Linden, New Jersey plant described below), and certain other environmental compliance expenses, as of December 31, 1998, is \$20.0 million, before reduction for insurance recoveries reflected on our balance sheet (discussed below) of \$10.7 million that relate to both past expenses and estimated future liabilities ("estimated recoveries"). In the opinion of management, the resolution of such matters should not be material to our business, liquidity, results of operations, cash flows or financial position. However, adverse decisions or events, particularly as to the liability and the financial responsibility of our insurers and of the other parties involved at each site and their insurers, could cause us to increase our estimate of our liability in respect of such matters. It is not currently possible to estimate the amount or range of any additional liability.

After considering the relevant legal issues and other pertinent factors, we believe that we will receive the estimated recoveries and that the recoveries could be well in excess of the current estimated liability for all Environmental Claims, although there can be no assurance in this regard. We believe we are entitled to substantially full defense and indemnity under our insurance policies for most Environmental Claims, although our insurers have not affirmed a legal obligation under the policies to provide indemnity for such claims.

In March 1995, GAF Corporation commenced litigation on behalf of itself and its predecessors, successors, subsidiaries and related corporate entities in the United States District Court for the District of New Jersey seeking amounts substantially in excess of the estimated recoveries. The court dismissed the action in December 1997 for lack of federal jurisdiction, and defendant insurers appealed the dismissal. The appeal was denied by the Third Circuit Court of Appeals in March 1999. In June 1997, GAF Corporation filed a similar action against the insurers in the Superior Court of New Jersey, Somerset County, which action is pending. While we believe that our claims are meritorious, we cannot be certain that we will prevail in our efforts to obtain amounts equal to, or in excess of, the estimated recoveries.

In June 1989, we entered into a Consent Order with the New Jersey Department of Environmental Protection ("NJDEP") requiring the development of a remediation plan for our closed Linden, New Jersey plant and the maintenance of financial assurances (currently \$7.5 million) to guarantee our performance. This Consent Order does not address any potential natural resource damage claims. In April 1993, NJDEP issued orders which require the prevention of discharge of contaminated groundwater and stormwater from the site and the elimination of other potential exposure concerns. We believe, although we cannot be certain, that, taking into account our plans for development of the site, we can comply with the NJDEP order at a cost of no more than \$7.5 million. See Item 1, "Business—Environmental Services."

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Executive Officers of the Registrant

The following table sets forth the name, age, position and other information with respect to ISP's executive officers. Under ISP's By-laws, each director and executive officer continues in office until ISP's next annual meeting of stockholders and until his or her successor is elected and qualified. As used in this section, "ISP" refers to both Old ISP prior to the merger of Old ISP into ISP Holdings and ISP subsequent to the merger.

<u>Name and Position Held</u>	<u>Age</u>	<u>Present Principal Occupation or Employment and Five-Year Employment History</u>
Samuel J. Heyman Chairman and Chief Executive Officer	60	Mr. Heyman has been a director, Chairman and Chief Executive Officer of ISP since its formation. Mr. Heyman also has been a director, Chairman and Chief Executive Officer of GAF Corporation and certain of its subsidiaries for more than five years. He has been a director and Chairman of BMCA since its formation, and was Chief Executive Officer of BMCA from June 1996 to January 1999. He is also the Chief Executive Officer, Manager and General Partner of a number of closely held real estate development companies and partnerships whose investments include commercial real estate and a portfolio of publicly traded securities.
Peter R. Heinze President and Chief Operating Officer	56	Dr. Heinze has been a director, President and Chief Operating Officer of ISP since November 1996. He was Senior Vice President, Chemicals of PPG Industries Inc., a glass products, coatings and resins, and chemical manufacturer from April 1993 to November 1996.

<u>Name and Position Held</u>	<u>Age</u>	<u>Present Principal Occupation or Employment and Five-Year Employment History</u>
Carl R. Eckardt Executive Vice President- Corporate Development	68	Mr. Eckardt has been a director of ISP since its formation and Executive Vice President, Corporate Development, of ISP since November 1996, which position he also held from ISP's formation to January 1994. From January 1994 to November 1996, Mr. Eckardt was President and Chief Operating Officer of ISP. Mr. Eckardt was Vice Chairman of GAF Corporation from November 1996 to January 1999 and a director of GAF Corporation for more than five years until January 1999. He was Executive Vice President of GAF Corporation for more than five years until November 1996.
James P. Rogers Executive Vice President-Finance	48	Mr. Rogers has been Executive Vice President-Finance of ISP since December 1996 and was Senior Vice President-Finance of ISP from November 1993 to December 1996. He was Treasurer of ISP from March 1992 to December 1994 and from September 1995 to December 1996. Mr. Rogers has been Executive Vice President and Chief Financial Officer of GAF Corporation and certain of its subsidiaries since December 1996, was Senior Vice President and Chief Financial Officer of such corporations from November 1993 to December 1996 and has served as Treasurer of such corporations since March 1992. Mr. Rogers has been a director of BMCA since its formation and Executive Vice President of BMCA since December 1996. He was Senior Vice President of such corporation from November 1993 to December 1996.
Andrew G. Mueller Executive Vice President- Operations	56	Mr. Mueller has been Executive Vice President-Operations of ISP since May 1997. He was employed by BASF Corporation as Group Vice President, Colorants & Textile/Leather Chemicals from December 1995 to April 1997 and as Vice President, Fiber Intermediates for more than five years until November 1995.
Richard A. Weinberg Executive Vice President, Secretary and General Counsel	39	Mr. Weinberg has been Executive Vice President, Secretary and General Counsel of ISP since May 1998 and was Senior Vice President, Secretary and General Counsel of ISP from May 1996 to May 1998. Mr. Weinberg has held the same positions during the same time periods with GAF Corporation and certain of its subsidiaries, including BMCA. He was Vice President and General Counsel of BMCA from September 1994 to May 1996, Vice President-Law of BMCA from May 1994 to September 1994 and Vice President-Law of GAF Building Materials Corporation from April 1993 to May 1994.
Randall R. Lay Senior Vice President and Chief Financial Officer	44	Mr. Lay has been Senior Vice President and Chief Financial Officer of ISP since December 1998 and was Vice President and Chief Financial Officer of ISP from April 1995 to December 1998. From August 1993 to April 1995, he served as Controller, Specialty Derivatives of ISP.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The following information pertains to ISP's common stock, which is traded on the New York Stock Exchange. As of March 19, 1999, there were 240 holders of record of ISP's outstanding common stock. For purposes of this section, "ISP" refers to both Old ISP for the periods prior to the merger of Old ISP into ISP Holdings and ISP for the periods subsequent to the merger.

	1998 by Quarter				1997 by Quarter			
	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
Price Range of Common Stock:								
High	\$18½	\$20½	\$18⅓/16	\$157/16	\$13¾	\$14¾	\$15¼	\$16½
Low	13⅞/16	16⅓/16	12	9⅞/16	11¾	11½	13½	13⅞

ISP announced in the second quarter of 1995 that its Board of Directors had eliminated the 2½ cents per share semi-annual dividend on ISP's common stock. The declaration and payment of dividends is at the discretion of the Board of Directors of ISP. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 9 to Consolidated Financial Statements for information regarding restrictions on the payment of dividends set forth on pages F-2 to F-10 and page F-26, respectively. Any decision to resume the payment of dividends, and the timing and amount thereof, is dependent upon, among other things, ISP's results of operations, financial condition, cash requirements, prospects and other factors deemed relevant by the Board of Directors. Accordingly, there can be no assurance that the Board of Directors will resume the declaration and payment of dividends or as to the amount thereof.

Item 6. Selected Financial Data

See page F-11.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

See page F-2.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Financial Condition—Market-Sensitive Instruments and Risk Management" on page F-8.

Item 8. Financial Statements and Supplementary Data

See Index on page F-1 and Financial Statements and Supplementary Data on pages F-13 to F-42.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information relating to the directors of ISP to be contained in the Proxy Statement under the heading "Election of Directors" is incorporated by reference herein. For information relating to the executive officers of ISP, see "Executive Officers of the Registrant" in Part I of this report.

Item 11. Executive Compensation

The information to be contained in the Proxy Statement under the headings "Compensation of Executive Officers of the Company" and "Election of Directors" is incorporated by reference herein.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information to be contained in the Proxy Statement under the heading "Security Ownership of Certain Beneficial Owners and Management" is incorporated by reference herein.

Item 13. Certain Relationships and Related Transactions

The information to be contained in the Proxy Statement under the headings "Election of Directors" and "Certain Transactions" is incorporated by reference herein.

PART IV**Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K**

The following documents are filed as part of this report:

- (a)(1) Financial Statements: See Index on page F-1.
- (a)(2) Financial Statement Schedules: See Index on page F-1.
- (a)(3) Exhibits:

<u>Exhibit Number</u>	<u>Descriptions</u>
3.1	— Amended and Restated Certificate of Incorporation of ISP (incorporated by reference to Exhibit 4.1 to Post-Effective Amendment No. 1 on Form S-8 to the Registration Statement on Form S-4 of ISP (Registration No. 333-53709) (the "ISP Registration Statement")).
3.2	— By-laws of ISP (incorporated by reference to Exhibit 99.2 to the ISP Registration Statement).
4.1	— 9% Note Indenture, dated as of October 18, 1996, between ISP Holdings and The Bank of New York, as trustee (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-4 of ISP Holdings (Registration No. 333-17827) (the "Holdings Registration Statement")).
4.2	— 9¾% Note Indenture, dated as of October 18, 1996, between ISP Holdings and The Bank of New York, as trustee (incorporated by reference to Exhibit 4.2 to the Holdings Registration Statement).
10.1	— Amended and Restated Management Agreement, dated as of January 1, 1999, among GAF Corporation, G-I Holdings Inc., G Industries Corp., Merick Inc., GAF Fiberglass Corporation, ISP, GAF Building Materials Corporation, GAF Broadcasting Company, Inc., BMCA and ISP Opco Holdings Inc (incorporated by reference to Exhibit 10.1 to BMCA's Annual Report on Form 10-K for the year ended December 31, 1998).
10.2	— Indemnification Agreement, dated as of October 18, 1996, among GAF Corporation, G-I Holdings Inc., ISP Holdings, G Industries Corp. and GAF Fiberglass Corporation (incorporated by reference to Exhibit 10.7 to the Holdings Registration Statement).
10.3	— Tax Sharing Agreement, dated as of January 1, 1997, among ISP Holdings, International Specialty Products Inc. and certain subsidiaries of International Specialty Products Inc. (incorporated by reference to Exhibit 10.8 to the Holdings Registration Statement).
10.4	— Non-Qualified Retirement Plan Letter Agreement (incorporated by reference to Exhibit 10.11 to the Registration Statement on Form S-1 of International Specialty Products Inc. (Registration No. 33-40351)).*

- 10.5 — International Specialty Products Inc. 1991 Incentive Plan for Key Employees and Directors, as amended (incorporated by reference to Exhibit 4.3 to Post-Effective Amendment No. 1 on Form S-8 to the ISP Registration Statement).*
- 10.6 — Agreement, dated July 30, 1993, between International Specialty Products Inc. and Carl R. Eckardt (incorporated by reference to Exhibit 10.16 to the Registration Statement on Form S-4 of G-I Holdings Inc. (Registration No. 33-72220)).*
- 10.7 — Letter Agreement, dated October 15, 1996, between GAF Corporation and Dr. Peter Heinze (incorporated by reference to Exhibit 10.14 to the Holdings Registration Statement).*
- 10.8 — Letter Agreement, dated July 15, 1998, between ISP and Dr. Peter Heinze (incorporated by reference to Exhibit 4.3 to ISP's Registration Statement on Form S-8 (Registration No. 333-62359)).*
- 10.9 — Stock Appreciation Rights Agreement, dated January 20, 1994, between GAF Corporation and James P. Rogers (incorporated by reference to Exhibit 10.20 to G-I Holdings Annual Report on Form 10-K for the year ended December 31, 1993).*
- 10.10 — Compensation and Indemnification Agreement among Charles M. Diker, Burt Manning and ISP, dated October 10, 1997 (incorporated by reference to Exhibit 10.23 to the ISP Registration Statement).*
- 10.11 — Agreement and Plan of Merger between ISP Holdings and International Specialty Products Inc., dated as of March 30, 1998 (incorporated by reference to Exhibit A to Amendment No. 2 to ISP Holdings Schedule 13D with respect to the common stock of International Specialty Products Inc. filed with the Securities and Exchange Commission on April 1, 1998).
- 21 — Subsidiaries of ISP.
- 23 — Consent of Arthur Andersen LLP.
- 27 — Financial Data Schedule for fiscal year 1998, which is submitted electronically to the Securities and Exchange Commission for information only.

* Management and/or compensation plan or arrangement.

(b) Reports on Form 8-K

No reports on Form 8-K were filed in the fourth quarter of 1998.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INTERNATIONAL SPECIALTY PRODUCTS INC.

By: /s/ RANDALL R. LAY
Randall R. Lay
Senior Vice President and Chief Financial Officer

Date: March 30, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 30, 1999, by the following persons on behalf of the Registrant and in the capacities indicated.

<u>Signature</u>	<u>Title</u>
<u>/s/ SAMUEL J. HEYMAN</u> Samuel J. Heyman	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
<u>/s/ PETER R. HEINZE</u> Peter R. Heinze	President and Chief Operating Officer; Director
<u>/s/ CARL R. ECKARDT</u> Carl R. Eckardt	Executive Vice President, Corporate Development; Director
<u>/s/ HARRISON J. GOLDIN</u> Harrison J. Goldin	Director
<u>/s/ CHARLES M. DIKER</u> Charles M. Diker	Director
<u>/s/ SANFORD KAPLAN</u> Sanford Kaplan	Director
<u>/s/ BURT MANNING</u> Burt Manning	Director
<u>/s/ RANDALL R. LAY</u> Randall R. Lay	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

**INTERNATIONAL SPECIALTY PRODUCTS INC.
FORM 10-K**

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INTERNATIONAL SPECIALTY PRODUCTS INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS

On July 15, 1998, International Specialty Products Inc. ("Old ISP") merged (the "Merger") with and into ISP Holdings Inc. ("ISP Holdings"). In connection with the Merger, ISP Holdings changed its name to International Specialty Products Inc. (the "Company"). In the Merger, each outstanding share of Old ISP's common stock, other than those held by ISP Holdings, was converted into one share of common stock of the Company, and the outstanding shares of ISP Holdings' common stock were converted into an aggregate of 53,833,333 shares (or approximately 78%) of the outstanding shares of common stock of the Company. The financial statements presented herein for periods prior to the Merger represent the results of the former ISP Holdings.

Prior to January 1, 1997, ISP Holdings was a wholly-owned subsidiary of GAF Corporation ("GAF"). On January 1, 1997, GAF effected a series of transactions (the "Separation Transactions") that resulted in, among other things, the capital stock of ISP Holdings being distributed to the stockholders of GAF. As a result of such distribution, ISP Holdings and Old ISP are no longer direct or indirect subsidiaries of GAF. Conversely, the assets and liabilities of the other wholly-owned subsidiaries of GAF, including G-I Holdings Inc. ("G-I Holdings") and its subsidiaries, including Building Materials Corporation of America ("BMCA"), U.S. Intec, Inc. ("U.S. Intec"), and GAF Fiberglass Corporation ("GFC"), are no longer included in the consolidated assets and liabilities of the Company.

Accordingly, the results of operations and assets and liabilities of G-I Holdings, BMCA, U.S. Intec and GFC, as well as the assets of GAF Broadcasting Company, Inc. (which were sold in August 1996), have been classified as "Discontinued Operations" within the financial statements for all periods presented prior to the Separation Transactions. The following discussion is on a continuing operations basis.

Results of Operations

1998 Compared With 1997

The Company recorded net income in 1998 of \$4.8 million (\$.08 diluted earnings per share) compared with net income of \$54.0 million (\$1.00 diluted earnings per share) in 1997. The results for 1998 reflect a restructuring and impairment loss of \$73.0 million and \$12.8 million of charges related to the Merger. Excluding the effect of such nonrecurring charges, net income for 1998 was \$64.1 million (\$1.05 diluted earnings per share), with the increase attributable to higher operating and other income, partially offset by higher interest expense.

Sales for 1998 were \$823.9 million, a 10% increase compared with \$749.2 million for 1997. The sales growth in 1998 was primarily attributable to the Company's acquisition, effective April 1, 1998, of the remaining 50% interest in its joint venture with Hüls AG, GAF Hüls Chemie GmbH ("GhC"), and to the acquisition of the Freetown fine chemicals facility (see Note 5 to Consolidated Financial Statements), which together accounted for \$74.5 million of the increase. In addition, the sales increase was attributable to increased sales volumes (\$9.0 million), offset by the unfavorable effect (\$9.8 million) of the stronger U.S. dollar relative to other currencies in certain areas of the world. The higher sales in 1998 reflect increased sales in the U.S., Europe (due to the sales of GhC) and Latin America, partially offset by lower sales in the Asia-Pacific region.

As discussed in Note 3 to Consolidated Financial Statements, the Company recorded \$73.0 million in 1998 for provisions for restructuring and impairment loss, primarily related to its decision to shut down its butanediol production unit at its Calvert City, Kentucky manufacturing facility. As a result of significant adverse changes in the butanediol market, and in conjunction with the decision to shut down the Calvert City butanediol production unit, the Company also reviewed the recoverability of its butanediol production assets at its Texas City and Seadrift, Texas facilities and, based on this review, took an impairment loss charge of \$16.6 million. The total charge related to the above shutdown and impairment aggregated \$59.3 million, including a total write-off of property, plant and equipment of \$38.7 million, the write-off of \$13.1 million of goodwill related to the butanediol business and an accrual of \$7.5 million for cash costs to be incurred, mainly for decommissioning, demolition and remediation, and severance costs. In addition, also as a result of the adverse changes in the

butanediol market and as a result of the acquisition of GhC, the Company decided not to continue its plans to acquire or develop a European manufacturing facility. Costs incurred in previous years for this project aggregating \$10.7 million were therefore deemed not recoverable and were written off in 1998. Also, in the third quarter of 1998, the Company reserved \$3.0 million for the consolidation of offices in the Company's European operations.

As a result of the Merger, the Company incurred \$12.8 million of charges against operating income in 1998, consisting of a \$7.9 million charge in connection with the termination of ISP Holdings' stock appreciation rights and preferred stock option programs, a \$2.6 million charge related to purchase accounting adjustments and \$2.2 million of other expenses relating to investment banking, legal and other fees.

Operating income, before the impact of the \$85.8 million of nonrecurring charges discussed above, was \$155.6 million for 1998, a 10% increase over the \$141.3 million recorded in 1997. The improved results were primarily attributable to higher operating income for the Performance Chemicals, Fine Chemicals and Industrial business segment (up \$22.8 million), mainly due to the acquisitions of GhC and the Freetown fine chemicals facility, and also due to higher operating income for Mineral Products (up \$3.5 million), partially offset by lower results for Personal Care (down \$9.3 million) and Pharmaceutical, Agricultural and Beverage (down \$0.8 million). See below for further discussion of business segment results. The overall operating results, in addition to the favorable effect of the acquisitions, were favorably impacted by increased sales volumes, partially offset by the adverse effect of the stronger U.S. dollar (\$15.7 million) and 6.5% higher selling, general and administrative expenses due primarily to higher distribution and marketing expenses. Selling, general and administrative expenses as a percent of sales decreased from 21.1% in 1997 to 20.4% in 1998.

Of the \$14.3 million increase in operating income, excluding the nonrecurring charges, domestic operating income increased by \$4.1 million (12%) due to increased sales volumes reflecting the acquisition of the Freetown fine chemicals facility and higher Mineral Products sales and, to a lesser extent, slightly higher gross margins. Operating income for Europe increased \$14.8 million due mainly to the GhC acquisition, partially offset by the effect of the stronger U.S. dollar, while in the Asia-Pacific region, operating income decreased by \$6.5 million due to lower sales volumes. Operating income for the Latin America region increased by \$1.9 million (12.5%) due to increased sales volumes and improved margins.

Interest expense for 1998 was \$75.6 million, a \$2.0 million (3%) increase over the \$73.6 million recorded in 1997, with the increase due primarily to higher average borrowings.

Other income, net, comprises net investment income, foreign exchange gains/losses resulting from the revaluation of foreign currency-denominated accounts receivable and payable as a result of changes in exchange rates, and other nonoperating and nonrecurring items of income and expense. Other income, net, was \$34.8 million in 1998 compared with \$34.2 million in 1997, as \$1.8 million lower other nonoperating and nonrecurring expense items were partially offset by \$1.2 million lower net investment income.

Business Segment Review

A discussion of operating results for each of the Company's business segments follows. The Company operates its Specialty Chemicals business through three reportable business segments, in addition to the Mineral Products and Filter Products segments. See Notes 13 and 14 to Consolidated Financial Statements for additional business segment and geographic information.

Personal Care

The Personal Care segment provides products to the skin and hair care markets. Sales in 1998 were \$189.4 million compared with \$187.4 million in 1997, while operating income declined in 1998 to \$34.7 million from \$44.0 million in 1997. Sales volumes increased by \$7.1 million in 1998, led by \$4.0 million in sales of new products. The stronger U.S. dollar adversely impacted sales by \$3.1 million and, in addition, the sunscreen market continued to experience lower average price levels in some products which offset volume improvements.

The decline in operating income in 1998 in the Personal Care segment was attributable to a \$4.7 million adverse impact of the stronger U.S. dollar, unfavorable prices in skin care products, and \$6.3 million higher selling, general and administrative expenses. The latter was primarily the result of increased expenses for new

product development, development and marketing expenses related to government regulations to reduce the emission of volatile organic compounds (VOCs) in hairsprays to 55% levels, and, to a lesser extent, higher distribution costs.

Pharmaceutical, Agricultural and Beverage ("PAB")

Sales for the PAB segment were \$210.6 million in 1998 compared with \$208.4 million in 1997, while operating income decreased to \$45.8 million in 1998 from \$46.6 million in 1997. The increased sales reflected higher sales volumes (\$2.5 million) and favorable pricing, offset by the adverse impact of the stronger U.S. dollar (\$3.7 million). The same factors impacted PAB's operating income, with the decline in operating income reflecting a \$6.2 million adverse impact of the stronger U.S. dollar, mostly offset by favorable pricing and increased sales volumes and by lower selling and distribution costs.

The Pharmaceutical business registered another year of strong growth, driven by the increased sales volumes in the oral care and excipients markets. The effects of the economic slowdown in Asia were largely offset by higher sales in Europe, and North and South America. The growth in the oral care market came primarily through increased sales of the Gantrez® product line, which has applications in both toothpaste and denture adhesives. In the excipients market, increased revenues were generated through higher sales of Plasdone®, which are polymers used as a drug tablet binder. Sales for 1998 in the antiseptic area were slightly down from 1997.

In the Agricultural business, the effects of the economic turmoil in Asia were disproportionate as customers in the region changed from preventive to remedial action. This unfavorably impacted the sales of Biodone and butenediol and the shortfalls could not be entirely offset in other parts of the world.

In the Beverage business, the economic situation in Asia and in certain parts of Eastern Europe had an unfavorable impact on sales, while sales in the Latin America region continued to grow in 1998.

Performance Chemicals, Fine Chemicals and Industrial

The Performance Chemicals, Fine Chemicals and Industrial segment experienced a 26% increase in sales in 1998, with sales increasing to \$290.1 million from \$230.0 million in 1997. Operating income improved to \$54.7 million, a 71% increase over the \$31.9 million recorded in 1997, excluding the restructuring and impairment loss previously discussed related to the butenediol business. The sales increase primarily reflected the acquisition of the remaining 50% interest in GhC and the acquisition of the Freetown fine chemicals facility (see Note 5 to Consolidated Financial Statements), which together accounted for \$74.5 million of the increase, and also reflected a substantial increase in the sales of pharmaceutical intermediates. The results for GhC are included in the Company's results on a consolidated basis from the date of acquisition, including sales of \$53.0 million for 1998. Sales for Performance Chemicals in 1998 were 3% lower than in 1997 due to weak economies in Asia and Eastern Europe. Pricing gains for Performance Chemicals were more than offset by the adverse impact of the stronger U.S. dollar.

The higher operating income for the Performance Chemicals, Fine Chemicals and Industrial segment in 1998 was also primarily attributable to the acquisitions of GhC and the Freetown facility and to the impact of sales volume increases, partially offset by unfavorable pricing and lower Performance Chemicals operating income due to adverse impact of the stronger U.S. dollar and, to a lesser extent, unfavorable manufacturing costs.

Mineral Products

Sales for the Mineral Products segment in 1998 were \$94.5 million, a 14% increase compared with \$83.1 million in 1997, while operating income improved 12% to \$20.5 million in 1998 compared with \$17.0 million in 1997. The sales growth resulted from an \$11.5 million increase in sales to an affiliate, BMCA (see Note 12 to Consolidated Financial Statements), resulting principally from higher volumes and slightly higher pricing. Sales to trade customers were flat due to consolidation in the roofing industry and plant closures at certain of the Company's trade customers. The Company also sold its tennis court materials business in 1998.

The improvement in operating income in 1998 resulted from the increased sales volumes and cost containment controls, and, to a lesser extent, the profit from the sale of the tennis court materials business.

Filter Products

Filter Products sales in 1998 were \$39.3 million compared with \$40.3 million in 1997, with the decrease due to lower sales volumes and the unfavorable effect of the stronger U.S. dollar. Operating income remained flat at \$3.6 million in each year.

1997 Compared With 1996

The Company recorded income from continuing operations before extraordinary loss in 1997 of \$54.0 million (\$1.00 diluted earnings per share) compared with \$60.8 million in 1996 (\$1.13 diluted earnings per share). The lower results were attributable to \$35.3 million higher interest expense, offset by a \$20.9 million increase in other income and a \$5.3 million increase in operating income.

Sales for 1997 were \$749.2 million, a 5% increase compared with \$716.5 million for 1996. The sales growth resulted from increased sales volumes (\$62.4 million), partially offset by a \$25.0 million unfavorable effect from the stronger U.S. dollar, and primarily reflected sales increases in the Performance Chemicals, Fine Chemicals and Industrial segment and the PAB segment. The sales increase in 1997 reflected higher sales in the United States, the Asia-Pacific region and Latin America, partially offset by lower sales in Europe due primarily to the unfavorable effect of the stronger U.S. dollar.

Operating income for 1997 increased by 4% to \$141.3 million compared with \$136.0 million for 1996. The increase was primarily attributable to higher operating income for the Performance Chemicals, Fine Chemicals and Industrial segment, and the Filter Products and PAB segments, partially offset by lower results for Personal Care. The higher consolidated operating income reflected the overall higher sales levels, partially offset by lower consolidated gross margins (down 0.5 percentage point) due to unfavorable pricing and the unfavorable effect of the stronger U.S. dollar, and by higher operating expenses which included a 7.5% increase in research and development spending.

Of the \$5.3 million increase in operating income in 1997, domestic operating income increased by \$13.8 million (21%), due to increased sales volumes and improved margins. Operating income for Europe decreased by \$8.7 million (16%), primarily reflecting the effect of the stronger U.S. dollar, while in the Asia-Pacific region, operating income decreased by \$1.2 million, as higher sales levels were offset by lower gross margins due to unfavorable pricing. Operating income from other foreign operations increased by \$1.4 million.

Interest expense was \$73.6 million in 1997 compared with \$38.3 million in 1996. The increase was attributable to the issuance in October 1996 of \$325 million principal amount of 9% Senior Notes due 2003 and \$199.9 million principal amount of 9¾% Senior Notes due 2002.

Other income, net, comprises net investment income, foreign exchange gains/losses resulting from the revaluation of foreign currency-denominated accounts receivable and payable as a result of changes in exchange rates, and other nonoperating and nonrecurring items of income and expense. Other income, net, was \$34.2 million in 1997 compared with \$13.3 million in 1996. The increase in 1997 was due principally to \$22.5 million higher net investment income.

Business Segment Review

Personal Care

Sales for the Personal Care segment were \$187.4 million in 1997 compared with \$190.7 million for 1996, while operating income decreased to \$44.0 million in 1997 from \$47.6 million in 1996. The decline in sales resulted from the unfavorable effect of the stronger U.S. dollar (\$5.8 million) and unfavorable pricing, which more than offset sales volume increases (\$7.3 million). The skin care product line recorded double-digit volume growth in 1997, mainly reflecting increased sales of sunscreen and cosmetic preservative products, partially offset by lower pricing for sunscreens. The hair care product line showed a 6% decrease in sales for 1997.

Operating income for the Personal Care segment decreased by 8% in 1997 compared with 1996 as a result of the unfavorable pricing, the adverse impact of the stronger U.S. dollar and increased marketing expenses, partially offset by the increased sales volumes.

Pharmaceutical, Agricultural and Beverage

Sales for the PAB segment were \$208.4 million in 1997, a 7% increase compared with \$194.9 million for 1996, while operating income increased 4.5% to \$46.6 million in 1997 compared with \$44.6 million in 1996. Sales and operating income increases in 1997 each resulted from significant sales volume increases, partially offset by the unfavorable effect of the stronger U.S. dollar.

In the Pharmaceutical business, the Company registered a strong performance in 1997, highlighted by substantial sales growth in the oral care and excipients markets. Sales of oral care polymers benefited from the U.S. rollout of Colgate's *Total*[®] toothpaste, the first toothpaste approved by the FDA to prevent gingivitis, plaque and cavities, and which contains one of the Company's Gantrez[®] polymers. Sales of the Company's beverage additives, consisting of the Polyclar[®] line of products, experienced good growth in the Latin America region, where sales increased more than 20%, and in the Asia-Pacific region.

Performance Chemicals, Fine Chemicals and Industrial

Sales for the Performance Chemicals, Fine Chemicals and Industrial segment increased by 12% to \$230.0 million in 1997 compared with \$205.7 million in 1996. The sales growth was driven by a 74% increase in Fine Chemicals sales, mainly from new pharmaceutical products and an agricultural herbicide. Sales of Performance Chemicals increased by 22% in 1997 due to adoption of ISP polymers into Dye Transfer Inhibitor (DTI) applications and continued growth in the Digital Printing and Imaging Market. In addition, the Company's sales to the household, institutional and industrial cleaning markets, in which the Company's PVP polymers find application, increased by 30% in 1997 as a result of increased geographic penetration and new product applications. Sales for the Industrial business increased by 2% in 1997, reflecting increased sales volumes partially offset by the adverse effect of the stronger U.S. dollar and unfavorable pricing. The Industrial business benefited in 1997 from the continued growth of a number of its end-use markets. Butanediol sales increased primarily as a result of higher demand from plastics manufacturers serving the automotive industry.

Operating income for the Performance Chemicals, Fine Chemicals and Industrial segment improved by 18% to \$31.9 million in 1997 from \$27.1 million in 1996. This improvement was attributable mainly to the Fine Chemicals business as a result of a favorable sales mix where higher-margin products were sold, coupled with favorable plant efficiencies in machine utilization and yields. Operating income in the Performance Chemicals business increased by 36%, reflecting the sales increases, partially offset by lower gross margins as a result of unfavorable pricing and the unfavorable effect of the stronger U.S. dollar. Operating income for the Industrial business decreased in 1997 as a result of unfavorable gross profit margins driven by the unfavorable pricing and adverse foreign exchange impact.

Mineral Products

Sales for the Mineral Products segment decreased by \$2.5 million in 1997 to \$83.1 million compared with \$85.6 million in 1996. The decrease in sales was mainly attributable to lower sales volumes to both BMCA and trade customers, partially offset by favorable pricing.

Despite lower sales levels, operating income for Mineral Products increased by \$0.5 million in 1997 to \$17.0 million due to higher gross margins (up 1.4 percentage points) as a result of improved pricing, and lower operating expenses.

Filter Products

Sales for the Filter Products segment were \$40.3 million in 1997 compared with \$39.6 million in 1996, with the increase attributable to both improved pricing and sales volume increases, mostly offset by the unfavorable effect of the stronger U.S. dollar. Operating income in 1997 increased to \$3.6 million from \$0.2 million in 1996. The improvement in 1997 reflected higher sales levels and higher gross margins (up 6.2 percentage points) due mainly to favorable pricing.

Liquidity and Financial Condition

During 1998, the Company's net cash outflow before financing activities was \$137.6 million, including \$186.8 million of cash generated from operations, the reinvestment of \$166.0 million for capital programs and acquisitions (see below and Note 5 to Consolidated Financial Statements), \$56.1 million of cash generated from a sale-leaseback related to an acquisition, and the use of \$216.8 million of cash for net purchases of available-for-sale and held-to-maturity securities and other short-term investments.

Cash from operations reflected a \$49.0 million cash inflow from net sales of trading securities and also included \$8.1 million of dividends received from the GhC joint venture prior to the Company's acquisition of the remaining interest in GhC. Working capital increased by \$5.3 million, primarily reflecting an \$11.9 million increase in inventories due to increased sales requirements as a result of the acquisitions made in 1998, partially offset by a \$2.2 million increase in payables and accrued liabilities and a decrease of \$2.6 million in receivables.

Net cash provided by financing activities in 1998 totaled \$141.7 million, mainly reflecting a \$97.6 million increase in borrowings under the Company's bank revolving credit facility, \$48.9 million additional short-term borrowings, and \$4.0 million proceeds from the sale of the Company's accounts receivable, partially offset by \$9.3 million of repurchases of common stock pursuant to the Company's repurchase program. The Company announced in September 1998 that its Board of Directors had approved the repurchase of one million shares of its common stock and announced in March 1999 the approval of the repurchase of an additional 1.5 million shares. The repurchased shares will be held for general purposes, including the issuance of shares under the Company's stock option plan.

As a result of the foregoing factors, cash and cash equivalents increased by \$4.1 million during 1998 to \$24.6 million, excluding \$355.0 million of trading, available-for-sale and held-to-maturity securities and other short-term investments.

As of December 31, 1998, the Company's current maturities of long-term debt, scheduled to be repaid during 1999, totaled \$0.6 million, excluding \$200 million relating to the Company's 9% Senior Notes due March 1999. The Company repaid the 9% Senior Notes on March 1, 1999 with long-term Credit Agreement (defined below) borrowings. In addition, the Company has received a one-year extension, to April 11, 2000, on the \$38.1 million mortgage obligation on its headquarters property. Accordingly, the 9% Senior Notes and the mortgage obligation are classified as long-term debt on the Consolidated Balance Sheet.

In July 1996, the Company entered into a new five-year revolving credit facility (the "Credit Agreement") with a group of banks, which provides for loans of up to \$400 million and letters of credit of up to \$75 million (see Note 9 to Consolidated Financial Statements). As of December 31, 1998, loans in the amount of \$132.6 million and letters of credit in the amount of \$7.9 million were outstanding under the Credit Agreement.

Borrowings by the Company, including those under the Credit Agreement, are subject to the application of certain financial covenants contained in such agreement and in the indentures relating to the 9% Senior Notes due 2003 and 9¾% Senior Notes due 2002 (collectively, the "Notes"). As of December 31, 1998, the Company was in compliance with such covenants, and the application of such covenants would not have restricted the amount available for borrowing under the Credit Agreement. The Credit Agreement and the indentures relating to the Notes limit the amount of cash dividends, purchases of treasury stock, and other restricted payments (as defined) by the Company. See Note 9 to Consolidated Financial Statements.

In February 1998, the Company acquired Polaroid Corporation's Freetown, Massachusetts fine chemicals facility. In connection with the acquisition, the Company entered into a sale-leaseback arrangement for the facility's equipment with a third party. The lease has been accounted for as an operating lease, with an initial term of four years and, at the Company's option, up to three one-year renewal periods. As part of the acquisition transaction, the Company entered into a long-term supply and license agreement with Polaroid for the imaging chemicals and polymers manufactured at the facility and used by Polaroid in its instant film business.

Effective April 1, 1998, the Company acquired the remaining 50% interest in the GhC joint venture. As part of the transaction, the Company also acquired Hül's production facility that supplies GhC with its primary raw material, acetylene. See Note 5 to Consolidated Financial Statements.

On July 22, 1998, the Company filed a shelf Registration Statement on Form S-3 with the U.S. Securities and Exchange Commission for \$1 billion of debt and equity securities. In addition to debt refinancing, the net proceeds of any offering, if consummated, are expected to be used for general corporate purposes.

For information with respect to income taxes, see Note 4 to Consolidated Financial Statements.

Effective January 1, 1999, member states of the European Union converted to a common currency, the euro. The Company does not expect this conversion to have a material impact on its business, results of operations or financial condition. The Company is currently billing customers in euro if they so request, and this has not had an impact on the Company's administrative systems.

The Company does not believe that inflation has had an effect on its results of operations during the past three years. However, there can be no assurance that the Company's business will not be affected by inflation in the future.

The Company has received site designation from the New Jersey Hazardous Waste Facilities Siting Commission for the construction of a hazardous waste treatment, storage and disposal facility at its Linden, New Jersey property and has received approval from the New Jersey Turnpike Authority for a direct access ramp from the Turnpike to the site. If the Company is successful in securing the necessary permits to construct and operate the hazardous waste facility, the Company intends to develop and operate the facility in a separate subsidiary, either on its own or in a joint venture with a suitable partner. The Company estimates that the cost of constructing the facility will be approximately \$100 million and, if approved, the facility is anticipated to be in operation three years after commencement of construction. The Company anticipates utilizing internally generated cash and/or seeking project or other independent financing for this project. Accordingly, the Company would not expect such facility to impact materially its liquidity or capital resources. The Company is also investigating additional development opportunities at this site.

The Company, together with other companies, is a party to a variety of proceedings and lawsuits involving environmental matters. See Note 16 to Consolidated Financial Statements for further information.

Market-Sensitive Instruments and Risk Management

The Company's investment strategy is to seek returns in excess of money market rates on its available cash while minimizing market risks. There can be no assurance that the Company will be successful in implementing such a strategy. The Company invests primarily in international and domestic arbitrage and securities of companies involved in acquisition or reorganization transactions, including at times, common stock short positions which are offsets against long positions in securities which are expected, under certain circumstances, to be exchanged or converted into the short positions. With respect to its equity positions, the Company is exposed to the risk of market loss. See Note 2 to Consolidated Financial Statements.

The Company enters into financial instruments in the ordinary course of business in order to manage its exposure to market fluctuations in interest rates, foreign currency rates, and on its short-term investments. The financial instruments the Company employs to reduce market risk include swaps, futures, forwards, and other hedging instruments. The financial instruments are subject to strict internal controls and their use is primarily confined to the hedging of the Company's debt, foreign currency exposure, and short-term investment portfolio. The counterparties to these financial instruments are major financial institutions with high credit standings. The amounts subject to credit risk are generally limited to the amounts, if any, by which the counterparties' obligations exceed the obligations of the Company. The Company controls credit risk through credit approvals,

limits and monitoring procedures. The Company does not anticipate nonperformance by counterparties to these instruments.

	December 31, 1997		December 31, 1998	
	Notional Amount	Fair Value	Notional Amount	Fair Value
	(Millions)			
Interest rate financial instruments	\$300.0	\$(3.3)	\$425.0	\$(10.2)
Foreign currency financial instruments	\$151.6	\$ 1.4	\$ 90.8	\$ (4.4)
Equity-related financial instruments	\$ —	\$ —	\$332.8	\$ 0

All of the financial instruments in the above table have a maturity of less than one year, except that \$100 million notional amount of interest rate swap agreements, with a fair value of \$(4.3) million as of December 31, 1998, mature in 2002.

The objectives of the Company in utilizing interest rate swap agreements are to lower funding costs, diversify sources of funding and manage interest rate exposure. As of December 31, 1998, the Company had entered into interest rate swap agreements with a notional value of \$225 million in order to convert \$225 million of its exposure to floating interest rates to fixed rates. The Company had also entered into interest rate swap agreements with a notional value of \$200 million in order to convert the fixed rate being paid on its \$200 million 9% Senior Notes due 1999 into floating rates. The 9% Senior Notes, the \$200 million notional value of fixed to floating interest rate swaps, and \$125 million notional amount of floating to fixed interest rate swaps matured on March 1, 1999. By utilizing interest rate swap agreements, the Company reduced its interest expense by \$2.8, \$2.1 and \$1.7 million in 1996, 1997 and 1998, respectively.

The Company enters into forward foreign exchange instruments with off-balance-sheet risk in order to hedge a portion of both its borrowings denominated in foreign currency and its firm or anticipated purchase commitments related to the operations of its foreign subsidiaries. Forward contract agreements require the Company and the counterparty to exchange fixed amounts of U.S. dollars for fixed amounts of foreign currency on specified dates. All forward contracts are in major currencies with highly liquid markets and mature within one year. Hedging strategies are approved by senior management before they are implemented. The Company does not expect the conversion to the euro currency by member states of the European Union to have a material impact on its use of financial instruments.

As of December 31, 1997 and 1998, the U.S. dollar equivalent fair value of outstanding forward foreign exchange contracts was \$151.6 and \$90.8 million, respectively. The U.S. dollar equivalent fair value of foreign exchange contracts outstanding as of December 31, 1997 and 1998 entered into as a hedge of non-local currency intercompany loans was \$24.9 and \$18.4 million, respectively, representing 100% of the Company's foreign currency exposure with respect to such loans.

As of December 31, 1998, equity-related financial instruments employed by the Company to reduce market risk include long contracts valued at \$56.1 million and short contracts valued at \$276.7 million, which are marked-to-market each month, with unrealized gains and losses included in the results of operations. As such, there is no economic cost at December 31, 1998 to terminate these instruments and therefore the fair market value is zero.

Year 2000 Compliance

The Company has implemented a formal Year 2000 program (the "Year 2000 Program") to (i) address the inability of some of its information technology ("IT") and "non-IT" equipment that the Company believes is significant to its business, including certain devices with embedded technology, to accurately read and process certain dates, including dates in the Year 2000 and afterwards (the "Year 2000 Issues"); (ii) investigate Year 2000 Issues of third parties significant to the Company's business; and (iii) establish contingency plans where appropriate.

The Company has completed the installation of a new Enterprise Resource Planning System ("ERP System") and has replaced or remediated most of its personal computers and other IT equipment that may have

Year 2000 Issues. Although the ERP System was implemented for purposes other than remediating Year 2000 Issues, management believes that the ERP System is Year 2000 compliant. In this regard, the Company has performed Year 2000 testing of the ERP system and did not discover any major Year 2000 Issues. With respect to its non-IT equipment, the Company and its consultants are presently inventorying, evaluating, remediating and testing this equipment. The Company expects to complete its Year 2000 Program for IT and non-IT equipment by mid-1999.

The Company is also requesting information on the Year 2000 Issues of third parties significant to the Company's business. The Company is evaluating the responses from many of these entities and is requesting more information as appropriate. Based on the information gathered from its Year 2000 Program, the Company is developing contingency plans to minimize the impact of Year 2000 Issues on its business. The Company expects to substantially complete these activities by mid-1999.

The Company does not believe that the costs of its Year 2000 Program will be material to its financial position or results of operations. While the Company believes that it addressed most of its IT Year 2000 Issues by installing the ERP System and replacing or remediating personal computers, neither the timing nor extent of these activities were directly related to the Company's Year 2000 Program. The Company also has incurred outside costs of approximately \$100,000 in connection with evaluating Year 2000 compliance of its non-IT systems. The Company anticipates that additional costs to remediate should approximate no more than \$1.5 million in the aggregate. The Company expects that the source of any funds that may be necessary to pay the costs of addressing its Year 2000 Issues will be provided from cash balances or cash generated from operations. The Company intends to charge such costs against earnings as the costs are incurred.

Management believes that it has taken reasonable steps in developing its Year 2000 Program. Notwithstanding these actions, there can be no assurance that all of the Company's Year 2000 Issues or those of its key suppliers, service providers or customers will be resolved or addressed satisfactorily before the Year 2000 commences. Management believes that the reasonably likely "worst case scenario" resulting from Year 2000 Issues could be the failure by the Company's key suppliers, service providers, customers and other third parties to address their Year 2000 Issues. If this were to occur, and there were no alternatives available to the Company, then the Company's usual channels of supply and distribution could be disrupted, in which event the Company could experience a material adverse impact on its business, results of operations or financial position.

* * *

Forward-looking Statements

This Annual Report on Form 10-K contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934. These forward-looking statements are only predictions and generally can be identified by use of statements that include phrases such as "believe," "expect," "anticipate," "intend," "plan," "foresee" or other words or phrases of similar import. Similarly, statements that describe the Company's objectives, plans or goals also are forward-looking statements. The Company's operations are subject to certain risks and uncertainties that could cause actual results to differ materially from those contemplated by the relevant forward-looking statement. The forward-looking statements included herein are made only as of the date of this Annual Report on Form 10-K and the Company undertakes no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances. No assurances can be given that projected results or events will be achieved.

INTERNATIONAL SPECIALTY PRODUCTS INC.

SELECTED FINANCIAL DATA

Set forth below are selected consolidated financial data of International Specialty Products Inc. (the "Company"), formerly ISP Holdings Inc. ("ISP Holdings"), and its subsidiaries. On July 15, 1998, International Specialty Products Inc. ("Old ISP") merged (the "Merger") with and into ISP Holdings. In connection with the Merger, ISP Holdings changed its name to International Specialty Products Inc. The financial information presented herein for periods prior to the Merger of Old ISP and ISP Holdings represent the results of the former ISP Holdings. Prior to January 1, 1997, ISP Holdings was a wholly-owned subsidiary of GAF Corporation ("GAF"). On January 1, 1997, GAF effected the Separation Transactions that resulted in, among other things, the capital stock of ISP Holdings being distributed to the stockholders of GAF. As a result of the Separation Transactions, ISP ceased to be a direct or indirect subsidiary of GAF, and GAF's subsidiaries are no longer included in the consolidated assets and liabilities of ISP. See Note 1 to Consolidated Financial Statements. The results of operations and assets and liabilities of GAF's subsidiaries, as well as GAF Broadcasting Company, Inc. (whose assets were sold in August 1996), have been classified as "Discontinued Operations" within the Consolidated Financial Statements for all periods presented prior to the Separation Transactions.

	Year Ended December 31,				
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(Dollars in thousands, except per share amounts)				
Operating Data:					
Net sales	\$ 600,047	\$ 689,002	\$ 716,481	\$ 749,208	\$ 823,938
Gross profit	232,301	274,330	297,560	312,328	338,568
Operating income	99,245	127,096	136,024	141,304	69,755
Interest expense	28,676	33,091	38,333	73,612	75,590
Income from continuing operations before income taxes and extraordinary losses	72,484	106,102	116,628	107,834	30,416
Income from continuing operations before extraordinary losses	37,112	55,069	60,836	54,005	4,812
Net income	28,010	32,828	53,933	54,005	4,812
Income from continuing operations per common share:					
Basic	\$.69	\$ 1.02	\$ 1.13	\$ 1.00	\$.08
Diluted	\$.69	\$ 1.02	\$ 1.13	\$ 1.00	\$.08
Other Data:					
Gross profit margin	38.7%	39.8%	41.5%	41.7%	41.1%
Operating margin	16.5%	18.4%	19.0%	18.9%	8.5%
Depreciation	\$ 32,753	\$ 35,960	\$ 38,279	\$ 41,877	\$ 50,063
Goodwill amortization	13,400	13,223	13,200	13,294	15,025
Capital expenditures and acquisitions	31,098	38,934	54,587	68,655	166,040

	December 31,				
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(Thousands)				
Balance Sheet Data:					
Total working capital	\$ 228,040	\$ 290,001	\$ 476,846	\$ 322,080	\$ 406,654
Total assets	1,357,541	1,460,389	1,600,432	1,485,680	1,765,623
Long-term debt less current maturities	285,397	280,254	834,284	798,762	896,095
Stockholders' equity (deficit)	(15,791)	(1,707)	42,653	261,841	501,723

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To International Specialty Products Inc.:

We have audited the accompanying consolidated balance sheets of International Specialty Products Inc. (a Delaware corporation) and subsidiaries as of December 31, 1997 and 1998, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above, appearing on pages F-13 to F-41 of this Form 10-K, present fairly, in all material respects, the financial position of International Specialty Products Inc. and subsidiaries as of December 31, 1997 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule appearing on page S-1 of this Form 10-K is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Roseland, New Jersey
February 24, 1999

INTERNATIONAL SPECIALTY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	1996	1997	1998
	(Thousands, except per share amounts)		
Net sales	<u>\$716,481</u>	<u>\$749,208</u>	<u>\$823,938</u>
Costs and expenses:			
Cost of products sold	418,921	436,880	485,370
Selling, general and administrative	148,336	157,730	167,953
Provision for restructuring and impairment loss	—	—	73,049
Merger-related expenses	—	—	12,786
Goodwill amortization	<u>13,200</u>	<u>13,294</u>	<u>15,025</u>
Total costs and expenses	<u>580,457</u>	<u>607,904</u>	<u>754,183</u>
Operating income	136,024	141,304	69,755
Interest expense	(38,333)	(73,612)	(75,590)
Equity in earnings of joint venture	5,604	5,909	1,455
Other income, net	<u>13,333</u>	<u>34,233</u>	<u>34,796</u>
Income from continuing operations before income taxes and extraordinary loss	116,628	107,834	30,416
Income taxes	(42,079)	(39,137)	(15,325)
Minority interest in income of subsidiary	<u>(13,713)</u>	<u>(14,692)</u>	<u>(10,279)</u>
Income from continuing operations before extraordinary loss	<u>60,836</u>	<u>54,005</u>	<u>4,812</u>
Discontinued operations:			
Loss from discontinued operations, net of income taxes	(19,590)	—	—
Gain on sale of discontinued operation, net of income taxes of \$30,648	<u>43,637</u>	<u>—</u>	<u>—</u>
Income from discontinued operations	<u>24,047</u>	<u>—</u>	<u>—</u>
Income before extraordinary loss	84,883	54,005	4,812
Extraordinary loss, net of income tax benefits of \$17,275	<u>(30,950)</u>	<u>—</u>	<u>—</u>
Net income	<u>\$ 53,933</u>	<u>\$ 54,005</u>	<u>\$ 4,812</u>
Earnings per common share:			
Basic:			
Income from continuing operations	\$ 1.13	\$ 1.00	\$.08
Income from discontinued operations45	—	—
Extraordinary loss	<u>(.58)</u>	<u>—</u>	<u>—</u>
Net income	<u>\$ 1.00</u>	<u>\$ 1.00</u>	<u>\$.08</u>
Diluted:			
Income from continuing operations	\$ 1.13	\$ 1.00	\$.08
Income from discontinued operations45	—	—
Extraordinary loss	<u>(.58)</u>	<u>—</u>	<u>—</u>
Net income	<u>\$ 1.00</u>	<u>\$ 1.00</u>	<u>\$.08</u>
Weighted average number of common and common equivalent shares outstanding:			
Basic	<u>53,833</u>	<u>53,833</u>	<u>60,971</u>
Diluted	<u>53,833</u>	<u>53,833</u>	<u>61,278</u>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

INTERNATIONAL SPECIALTY PRODUCTS INC.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	1997	1998
	(Thousands)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 20,495	\$ 24,638
Investments in trading securities	67,493	67,333
Investments in available-for-sale securities	140,812	233,625
Investments in held-to-maturity securities	311	12,287
Other short-term investments	26,682	41,708
Accounts receivable, trade, less reserve of \$2,724 and \$2,789	67,077	82,227
Accounts receivable, other	25,288	21,748
Receivable from related parties, net	4,124	7,769
Inventories	119,910	138,888
Other current assets	16,773	19,624
Total Current Assets	489,415	649,847
Property, plant and equipment, net	518,922	553,195
Excess of cost over net assets of businesses acquired, net of accumulated amortization of \$118,319 and \$133,344	409,886	526,928
Other assets	67,457	35,653
Total Assets	\$1,485,680	\$1,765,623
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Short-term debt	\$ 39,076	\$ 87,937
Current maturities of long-term debt	684	583
Accounts payable	46,283	61,722
Accrued liabilities	74,092	84,534
Income taxes	7,200	8,417
Total Current Liabilities	167,335	243,193
Long-term debt less current maturities	798,762	896,095
Deferred income taxes	67,918	60,282
Other liabilities	63,493	64,330
Minority interest in subsidiary	126,331	—
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, \$.01 par value per share; 20,000,000 shares authorized; no shares issued	—	—
Common stock, \$.01 par value per share; 300,000,000 shares authorized; 53,833,333 and 69,546,456 shares issued	538	695
Additional paid-in capital	212,413	489,285
Treasury stock, at cost—735,744 shares	—	(8,388)
Retained earnings	40,080	44,892
Accumulated other comprehensive income (loss)	8,810	(24,761)
Total Stockholders' Equity	261,841	501,723
Total Liabilities and Stockholders' Equity	\$1,485,680	\$1,765,623

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

INTERNATIONAL SPECIALTY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1996	1997	1998
	(Thousands)		
Cash and cash equivalents, beginning of year	\$ 14,080	\$ 17,938	\$ 20,495
Cash provided by operating activities:			
Net income	53,933	54,005	4,812
Adjustments to reconcile net income to net cash provided by operating activities:			
Income from discontinued operations	(24,097)	—	—
Extraordinary loss	30,950	—	—
Provision for restructuring and impairment loss	—	—	73,049
Depreciation	38,279	41,877	50,063
Goodwill amortization	13,200	13,294	15,025
Deferred income taxes	(2,494)	28,570	(6,816)
(Increase) decrease in working capital items	2,532	(18,925)	(5,310)
Purchases of trading securities	(43,236)	(196,513)	(223,062)
Proceeds from sales of trading securities	47,901	119,864	272,027
Decrease in other assets	385	2,200	3,129
Increase (decrease) in other liabilities	(31)	9,702	135
Change in net receivable from/payable to affiliates	(14,665)	1,112	(3,645)
Change in cumulative translation adjustment	(6,943)	(6,238)	2,975
Change in minority interest in subsidiary	12,360	13,552	9,730
Other, net	(561)	(7,967)	(5,281)
Net cash provided by operating activities	107,563	54,533	186,831
Cash used in investing activities:			
Capital expenditures and acquisitions	(54,587)	(68,655)	(166,040)
Proceeds from sale-leaseback transaction	—	—	56,050
Proceeds from sale of assets	—	—	2,400
Proceeds from sale of discontinued operation	89,464	—	—
Other cash used in discontinued operations	(84,655)	—	—
Purchases of available-for-sale securities	(339,472)	(301,207)	(671,842)
Purchases of held-to-maturity securities	(14,331)	(1,623)	(12,287)
Purchases of other short-term investments	(16,550)	—	(10,000)
Proceeds from sales of available-for-sale securities	301,851	344,408	477,014
Proceeds from held-to-maturity securities	16,972	3,289	311
Net cash used in investing activities	(101,308)	(23,788)	(324,394)
Cash provided by (used in) financing activities:			
Proceeds from sale of accounts receivable	2,000	—	4,000
Increase (decrease) in short-term debt	(14,249)	16,794	48,861
Proceeds from issuance of long-term debt	324,093	—	—
Tender Offer of G-I Holdings Discount Notes	(376,345)	—	—
Repurchase of Discount Notes by G-I Holdings	178,861	—	—
Increase (decrease) in borrowings under revolving credit facility	29,625	(35,425)	97,600
Other increase (decrease) in long-term debt, net	543	(153)	(643)
Decrease in loans from affiliate	(117,834)	—	—
Financing fees and expenses	(8,642)	(790)	(174)
Repurchases of common stock	—	—	(9,326)
Subsidiary's repurchases of common stock	(15,134)	(10,240)	—
Dividends and distributions to parent company	(68,049)	—	—

INTERNATIONAL SPECIALTY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS—(Continued)

	Year Ended December 31,		
	1996	1997	1998
	(Thousands)		
Capital contribution from parent company	61,558	—	—
Other, net	1,176	1,626	1,388
Net cash provided by (used in) financing activities	(2,397)	(28,188)	141,706
Net change in cash and cash equivalents	3,858	2,557	4,143
Cash and cash equivalents, end of year	<u>\$ 17,938</u>	<u>\$ 20,495</u>	<u>\$ 24,638</u>
Supplemental Cash Flow Information:			
Effect on cash from (increase) decrease in working capital items*:			
Accounts receivable	\$ (8,884)	\$ (12,655)	\$ 2,581
Inventories	(575)	(11,137)	(11,894)
Other current assets	(967)	(2,547)	778
Accounts payable	1,712	3,694	8,985
Accrued liabilities	11,511	4,989	(6,755)
Income taxes	(265)	(1,269)	995
Net effect on cash from (increase) decrease in working capital items ..	<u>\$ 2,532</u>	<u>\$ (18,925)</u>	<u>\$ (5,310)</u>
Cash paid during the period for:			
Interest (net of amount capitalized)	\$ 33,583	\$ 71,512	\$ 76,615
Income taxes paid (refunded) (including taxes paid pursuant to the Tax Sharing Agreement)	61,701	(1,755)	22,109
Acquisition of remaining 50% interest in GAF-Hüls Chemie GmbH joint venture, net of \$23,732 cash acquired**:			
Fair market value of assets acquired			\$ 48,003
Purchase price of acquisition			<u>23,381</u>
Liabilities assumed			<u>\$ 24,622</u>

* Working capital items exclude cash and cash equivalents, short-term investments, short-term debt and payables to and receivables from related parties. Working capital acquired in connection with acquisitions is reflected within "Capital expenditures and acquisitions." The effects of reclassifications between noncurrent and current assets and liabilities are excluded from the amounts shown above. In addition, the increase in accounts receivable shown above does not reflect the cash proceeds from the sale of the Company's domestic trade accounts receivable (see Note 6); such proceeds are reflected in cash from financing activities. As discussed in Note 9, in October 1996, the Company issued \$199.9 million of its 9 3/4% Senior Notes due 2002 in a noncash exchange offer for G-I Holdings' Series B 10% Senior Notes due 2006.

** The Company had a 50% equity interest in the cash held by the joint venture prior to the acquisition, which was classified within Other Assets on the Consolidated Balance Sheet.

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

INTERNATIONAL SPECIALTY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Capital Stock and Additional Paid-In Capital	Treasury Stock at Cost	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Comprehensive Income (Loss)
	(Thousands)				
Balance, December 31, 1995	\$ 56,342	\$ —	\$ 14,556	\$ —	
Comprehensive income, year ended December 31, 1996:					
Net income	—	—	—	53,933	\$ 53,933
Other comprehensive income, net of tax:					
Unrealized holding gains, net of income taxes of \$4,193			6,293		6,293
Less: Reclassification adjustment for gains included in net income, net of income taxes of \$3,048			4,961		4,961
Unrealized gains on available-for-sale securities	—	—	1,332	—	1,332
Translation adjustment	—	—	(6,943)	—	(6,943)
Minimum pension liability adjustment	—	—	1,207	—	1,207
Comprehensive income					\$ 49,529
Dividends and distributions to parent company	—	—	—	(67,858)	
Capital contribution from parent company	61,683	—	—	—	
Reclassification to additional paid-in capital of the excess of purchase price over the adjusted historical cost of predecessor company shares	(72,605)	—	—	—	
Effect of exercises of subsidiary's stock options	717	—	—	—	
Effect of subsidiary's issuances of stock and options as incentives	289	—	—	—	
Balance, December 31, 1996	\$ 46,426	\$ —	\$ 10,152	\$(13,925)	
Comprehensive income, year ended December 31, 1997:					
Net income	—	—	—	54,005	\$ 54,005
Other comprehensive income, net of tax:					
Unrealized holding gains, net of income taxes of \$7,849			16,467		16,467
Less: Reclassification adjustment for gains included in net income, net of income taxes of \$4,781			10,834		10,834
Unrealized gains on available-for-sale securities	—	—	5,633	—	5,633
Translation adjustment	—	—	(6,238)	—	(6,238)
Effect of Separation Transactions on components of accumulated other comprehensive income (loss)	—	—	(155)	—	(155)
Minimum pension liability adjustment	—	—	(582)	—	(582)
Comprehensive income					\$ 52,663
Effect of Separation Transactions	165,840	—	—	—	
Effect of purchases of treasury stock	(1,851)	—	—	—	
Effect of exercises of subsidiary's stock options	1,945	—	—	—	
Effect of subsidiary's issuances of stock and options as incentives	591	—	—	—	
Balance, December 31, 1997	\$212,951	\$ —	\$ 8,810	\$ 40,080	
Comprehensive income (loss), year ended December 31, 1998:					
Net income	—	—	—	4,812	\$ 4,812
Other comprehensive income (loss), net of tax:					
Unrealized holding losses, net of income tax benefit of \$600			(5,546)		(5,546)
Less: Reclassification adjustment for gains included in net income, net of income taxes of \$13,322			26,782		26,782
Unrealized losses on available-for-sale securities	—	—	(32,328)	—	(32,328)
Translation adjustment	—	—	2,975	—	2,975
Effect of the Merger on components of accumulated other comprehensive income (loss)	—	—	(196)	—	(196)
Minimum pension liability adjustment	—	—	(4,022)	—	(4,022)
Comprehensive income (loss)					\$(28,759)
Repurchases of common stock of ISP Holdings	—	(1,312)	—	—	
Effect of the Merger	275,982	1,312	—	—	
Repurchases of common stock—816,300 shares	—	(9,326)	—	—	
Issuances under stock option plan—80,556 shares	—	938	—	—	
Excess of proceeds over cost of treasury stock issued	1,570	—	—	—	
Effect of exercises of subsidiary's stock options	(2,019)	—	—	—	
Effect of issuances of stock options as incentives	1,496	—	—	—	
Balance, December 31, 1998	\$489,980	\$(8,388)	\$(24,761)	\$ 44,892	

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Formation of the Company and Merger of International Specialty Products Inc. into ISP Holdings Inc.

On July 15, 1998, International Specialty Products Inc. ("Old ISP") merged (the "Merger") with and into ISP Holdings Inc. ("ISP Holdings"). In connection with the Merger, ISP Holdings changed its name to International Specialty Products Inc. (the "Company"). In the Merger, each outstanding share of Old ISP's common stock, other than those held by ISP Holdings, was converted into one share of common stock of the Company, and the outstanding shares of ISP Holdings' common stock were converted into an aggregate of 53,833,333 shares (or approximately 78%) of the outstanding shares of common stock of the Company. The financial statements presented herein for periods prior to the Merger represent the results of the former ISP Holdings.

As a result of the Merger, the Company incurred \$12.8 million of charges against operating income in 1998, consisting of a \$7.9 million charge in connection with the termination of ISP Holdings' stock appreciation rights and preferred stock option programs, a \$2.6 million charge related to purchase accounting adjustments and \$2.2 million of other expenses relating to investment banking, legal and other fees.

Prior to January 1, 1997, ISP Holdings was a wholly-owned subsidiary of GAF Corporation ("GAF"). ISP Holdings was formed on August 6, 1996 and 10 shares of its common stock were issued to GAF in exchange for all of the capital stock of G-I Holdings Inc. ("G-I Holdings"), which resulted in G-I Holdings becoming a direct wholly-owned subsidiary of ISP Holdings.

The accompanying Consolidated Financial Statements have been prepared on a basis which retroactively reflects the formation of ISP Holdings, as discussed above, for all periods presented. The net income for each period presented up to the date ISP Holdings was formed has been reflected as dividends and/or distributions to GAF.

On January 1, 1997, GAF effected a series of transactions (the "Separation Transactions") that resulted in, among other things, the capital stock of ISP Holdings being distributed to the stockholders of GAF. As a result of such distribution, ISP Holdings and Old ISP are no longer direct or indirect subsidiaries of GAF. Conversely, the assets and liabilities of the other wholly-owned subsidiaries of G-I Holdings, including Building Materials Corporation of America ("BMCA"), U.S. Intec, Inc. ("U.S. Intec"), and GAF Fiberglass Corporation ("GFC"), are no longer included in the consolidated assets and liabilities of the Company.

Accordingly, the results of operations and assets and liabilities of G-I Holdings, BMCA, U.S. Intec and GFC, as well as GAF Broadcasting Company, Inc. (whose assets were sold in August 1996), have been classified as "Discontinued Operations" within the financial statements for all periods presented prior to the Separation Transactions.

The Company is engaged principally in the manufacture and sale of a wide range of specialty chemicals, mineral products and filter products. See Notes 13 and 14 for a description of and financial information relating to the Company's business segments and foreign and domestic operations.

See Note 15 for information related to discontinued operations.

Note 2. Summary of Significant Accounting Policies

Principles of Consolidation

All subsidiaries are consolidated and intercompany transactions have been eliminated.

Financial Statement Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make certain estimates. Actual results could differ from those estimates. In the opinion of management, the financial statements herein contain all adjustments necessary to present fairly the financial

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 2. Summary of Significant Accounting Policies—(Continued)

position and the results of operations and cash flows of the Company for the periods presented. The Company has a policy to review the recoverability of long-lived assets and identify and measure any potential impairments. The Company does not anticipate any changes in management estimates that would have a material impact on operations, liquidity or capital resources.

Short-term Investments

For securities classified as "trading" (including short positions), unrealized gains and losses are reflected in income. For securities classified as "available-for-sale," unrealized gains and losses, net of income tax effect, are included in a separate component of stockholders' equity, "Accumulated other comprehensive income (loss)," and amounted to \$8.0 and \$(24.0) million as of December 31, 1997 and 1998, respectively. Investments classified as "held-to-maturity" securities are carried at amortized cost in the Consolidated Balance Sheets.

Included in "Investments in available-for-sale securities" at December 31, 1998 is a \$136.3 million investment (based on market value) in Life Technologies, Inc. Such investment represents approximately 15% of the total outstanding common stock of Life Technologies, Inc.

"Other income, net," includes \$20.7, \$46.7 and \$43.2 million of net realized and unrealized gains on securities in 1996, 1997 and 1998, respectively. The determination of cost in computing realized gains and losses is based on the specific identification method.

As of December 31, 1997 and 1998, the market value of the Company's equity securities held long was \$207.0 and \$320.7 million, respectively, and the Company had \$29.5 and \$82.4 million, respectively, of short positions in common stocks, based on market value. As of December 31, 1997 and 1998, the market value of the Company's held-to-maturity securities was \$0.3 and \$12.3 million, respectively. The Company enters into equity-related financial instruments with off-balance-sheet risk as a means to manage its exposure to market fluctuations on its short-term investments. As of December 31, 1998, the value of equity-related short contracts was \$276.7 million, while the value of equity-related long contracts was \$56.1 million, both of which are marked-to-market each month, with unrealized gains and losses included in the results of operations. The market values referred to above are based on quotations as reported by various stock exchanges and major broker-dealers. With respect to its investments in securities, the Company is exposed to the risk of market loss.

"Other short-term investments" are investments in limited partnerships which are accounted for by the equity method. Gains and losses are reflected in "Other income, net." Liquidation of partnership interests generally require a 30 to 45 day notice period.

Cash and cash equivalents include cash on deposit and debt securities purchased with original maturities of three months or less.

Inventories

Inventories are stated at the lower of cost or market. The LIFO (last-in, first-out) method is utilized to determine cost for a substantial portion of the Company's domestic inventories. All other inventories are determined principally based on the FIFO (first-in, first-out) method.

Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is computed principally on the straight-line method based on the estimated economic lives of the assets. The Company uses an economic life of 10-20 years for land improvements, 40 years for buildings, and 3-20 years for machinery and equipment, which includes furniture and fixtures. Certain interest charges are capitalized during the period of construction as part of the cost of property, plant and equipment.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 2. Summary of Significant Accounting Policies—(Continued)

Foreign Exchange Contracts

The Company enters into forward foreign exchange instruments with off-balance-sheet risk in order to hedge a portion of both its borrowings denominated in foreign currency and its firm or anticipated purchase commitments related to the operations of foreign subsidiaries. Gains and losses on instruments used to hedge firm purchase commitments are deferred, and amortization is included in the measurement of the foreign currency transactions hedged. Gains and losses on instruments used to hedge anticipated purchases are recognized within "Other income, net."

Forward contract agreements require the Company and the counterparty to exchange fixed amounts of U.S. dollars for fixed amounts of foreign currency on specified dates. The market value of such contracts varies with changes in the market exchange rates. The Company is exposed to credit loss in the event of nonperformance by the counterparties to the forward contract agreements. However, the Company does not anticipate nonperformance by the counterparties. The Company does not generally require collateral or other security to support these financial instruments.

As of December 31, 1997 and 1998, the U.S. dollar equivalent fair value of outstanding forward foreign exchange contracts was \$151.6 and \$90.8 million, respectively, and the amount of net unrealized gains (losses) on such instruments was \$1.4 and (\$4.4) million at December 31, 1997 and 1998, respectively. All forward contracts are in major currencies with highly liquid markets and mature within one year. The Company uses quoted market prices obtained from major financial institutions to determine the market value of its outstanding forward exchange contracts. In addition, the U.S. dollar equivalent fair value of foreign exchange contracts outstanding as of December 31, 1997 and 1998 entered into as a hedge of non-local currency intercompany loans was \$24.9 and \$18.4 million, respectively, representing 100% of the Company's foreign currency exposure with respect to such loans.

The Company continually monitors its risk from the effects of foreign currency fluctuations on its operations and on the derivative products used to hedge its risk. The Company utilizes real-time, on-line foreign exchange data and news as well as evaluation of economic information provided by financial institutions. Mark-to-market valuations are made on a regular basis. Hedging strategies are approved by senior management before being implemented.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries, other than those located in highly inflationary countries, are translated at year-end exchange rates. The effects of these translation adjustments are reported in a separate component of stockholders' equity, "Accumulated other comprehensive income (loss)," and amounted to \$1.4 and \$4.0 million as of December 31, 1997 and 1998, respectively. Income and expenses are translated at average exchange rates prevailing during the year. Exchange gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved, and translation adjustments of subsidiaries in countries with highly inflationary economies, are included in "Other income, net".

Excess of Cost Over Net Assets of Businesses Acquired ("Goodwill")

Goodwill, which arose principally from the 1989 management-led buyout (the "Acquisition") of the predecessor company to the Company's former parent company, GAF, and as a result of the Merger (see Note 1), is amortized on the straight-line method over a period of approximately 40 years. The Company believes that the goodwill is recoverable. To determine if goodwill is recoverable, the Company compares the net carrying amount to undiscounted projected cash flows of the underlying businesses to which the goodwill pertains. If goodwill is not recoverable, the Company would record an impairment based on the difference between the net carrying amount and fair value.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 2. Summary of Significant Accounting Policies—(Continued)

Debt Issuance Costs

Debt issuance costs are amortized to expense over the life of the related debt.

Interest Rate Swaps

Gains (losses) on interest rate swap agreements ("swaps") are deferred and amortized as a reduction (increase) of interest expense over the remaining life of the debt issue with respect to which the swaps were entered.

Research and Development

Research and development costs are charged to operations as incurred and amounted to \$25.4, \$27.3 and \$26.3 million for 1996, 1997 and 1998, respectively.

Earnings per Common Share

In February 1997, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share", which requires the Company to present Basic Earnings per Share and Diluted Earnings per Share. Earnings per share data for all periods prior to the Merger are calculated based on the 53,833,333 shares of the Company's common stock held by ISP Holdings' stockholders. For periods subsequent to the Merger, "Basic Earnings per Share" are calculated based on the total weighted average number of shares of the Company's common stock outstanding during the period. "Diluted Earnings per Share" for periods subsequent to the Merger give effect to all potential dilutive common shares outstanding during the period under the Company's 1991 Incentive Plan for Key Employees and Directors (see Note 11).

Investment in Joint Venture

Prior to April 1, 1998, the Company had a 50% equity ownership in GAF-Hüls Chemie GmbH ("GhC"), a joint venture which operated a chemical manufacturing plant in Germany, and was accounted for by the equity method. Effective April 1, 1998, the Company acquired the remaining 50% interest in GhC (see Note 5). The Company's equity in the net assets of GhC was \$34.3 million as of December 31, 1997, and is included in "Other assets." Dividends received by the Company from GhC totaled \$5.7, \$6.3 and \$8.1 million for 1996, 1997 and 1998, respectively.

Environmental Liability

The Company, together with other companies, is a party to a variety of proceedings and lawsuits involving environmental matters. The Company estimates that its liability in respect of such environmental matters, and certain other environmental compliance expenses, as of December 31, 1998, is \$20.0 million, before reduction for insurance recoveries reflected on its balance sheet of \$10.7 million. The Company's liability is reflected on an undiscounted basis. See Note 16 for further discussion with respect to environmental liabilities and estimated insurance recoveries.

Accumulated Other Comprehensive Income (Loss)

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting comprehensive income and its components in annual and interim financial statements. The Company adopted SFAS No. 130 as of January 1, 1998 and has reclassified financial statements for earlier periods. In the Company's case, comprehensive income includes net income, unrealized gains and losses from investments in available-for-sale securities, net of income tax effect, foreign currency translation adjustments,

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 2. Summary of Significant Accounting Policies—(Continued)

and minimum pension liability adjustments. The Company has chosen to disclose Comprehensive Income in the Consolidated Statements of Stockholders' Equity.

Changes in the components of "Accumulated other comprehensive income (loss)" for the years 1996, 1997 and 1998 are as follows:

	Unrealized Gains (Losses) on Available- for-Sale Securities	Cumulative Foreign Currency Translation Adjustment	Minimum Pension Liability Adjustment	Accumulated Other Comprehensive Income (Loss)
	(Thousands)			
Balance, December 31, 1995	\$ 1,750	\$14,096	\$(1,290)	\$ 14,556
Change for the year 1996	1,332	(6,943)	1,207	(4,404)
Balance, December 31, 1996	\$ 3,082	\$ 7,153	\$ (83)	\$ 10,152
Change for the year 1997	4,925	(5,768)	(499)	(1,342)
Balance, December 31, 1997	\$ 8,007	\$ 1,385	\$ (582)	\$ 8,810
Change for the year 1998	(32,044)	2,606	(4,133)	(33,571)
Balance, December 31, 1998	<u>\$(24,037)</u>	<u>\$ 3,991</u>	<u>\$(4,715)</u>	<u>\$(24,761)</u>

New Accounting Standard

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement.

SFAS No. 133 is effective for fiscal years beginning after June 15, 1999, but may be adopted earlier. The Company has not yet determined the effect of adoption of SFAS No. 133 and has not determined the timing or method of adoption of the statement. Adoption of SFAS No. 133 could increase volatility in earnings and other comprehensive income.

Note 3. Provision for Restructuring and Impairment Loss

The Company announced in January 1999 that it was shutting down its butanediol production unit at its Calvert City, Kentucky manufacturing facility. The decision to shut down this production unit, the Company's highest-cost butanediol production, resulted from significant adverse changes in the butanediol market and the Company's acquisition of the remaining 50% interest in GhC (see Note 5). Accordingly, the Company recorded a one-time restructuring charge against operating income of \$42.7 million, as detailed below.

In conjunction with the decision to shut down the butanediol production unit in Calvert City, the Company also reviewed its butanediol production assets at its Texas City and Seadrift, Texas manufacturing facilities to determine if the carrying amount of such assets was recoverable. As a result of determining that the expected undiscounted cash flows of the assets is less than their carrying amount, the Company recognized an impairment loss of \$16.6 million to write down these assets to fair value.

Prior to acquiring the remaining 50% interest in GhC, the Company intended to acquire or develop a European manufacturing facility to meet the needs of the Company's European business. Costs incurred in previous years for this project totaled \$10.7 million and were included in "Construction in progress" at December 31, 1997. Such costs represented site evaluation, engineering, infrastructure and future technology.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 3. Provision for Restructuring and Impairment Loss—(Continued)

Based on the Company's decision to discontinue this project as no longer needed as a result of the adverse changes in the butanediol market and the GhC acquisition, these costs are no longer recoverable and were written off in the fourth quarter of 1998.

In the third quarter of 1998, the Company reserved \$3.0 million for the consolidation of offices in its European operations, consisting of \$0.5 million for severance related to 52 terminated employees in the sales and marketing, finance and accounting, and the supply chain departments, \$1.7 million for lease obligations and \$0.8 million for the relocation of headquarters operations and other related expenses. As of December 31, 1998, this accrual had a remaining balance of \$1.8 million.

Following is a detail of the \$73.0 million provision for restructuring and impairment loss:

	<u>(Millions)</u>
Write-off of Calvert City production assets	\$22.1
Impairment loss on Texas City and Seadrift assets	16.6
Write-off of goodwill related to the butanediol business	13.1
Write-off of fixed asset costs related to the terminated European expansion project	10.7
Accrual for decommissioning, demolition and remediation costs	4.7
Accrual for severance costs	0.9
Accrual for costs related to termination of raw material contracts and other related costs	1.9
Accrual for consolidation of European offices	<u>3.0</u>
Total provision	<u>\$73.0</u>

Of the total \$70.0 million provision recorded in the fourth quarter of 1998, \$7.5 million represents cash costs to be incurred, mainly in 1999, including severance costs of \$0.9 million for 41 terminated employees who were operators and supervisors in the butanediol production unit that was shut down. As a result of the write-off of property, plant and equipment and goodwill, the Company estimates that its depreciation expense will be lowered by approximately \$4.5 million per year and that goodwill amortization will be lowered by approximately \$0.4 million per year.

Note 4. Income Taxes

Income tax (provision) benefit for continuing operations consists of the following:

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
	<u>(Thousands)</u>		
Federal:			
Current	\$(35,743)	\$ (2,957)	\$ (815)
Deferred	<u>2,071</u>	<u>(27,832)</u>	<u>6,598</u>
Total Federal	<u>(33,672)</u>	<u>(30,789)</u>	<u>5,783</u>
Foreign-current	<u>(6,648)</u>	<u>(5,394)</u>	<u>(19,919)</u>
State and local:			
Current	(2,182)	(2,216)	(1,407)
Deferred	<u>423</u>	<u>(738)</u>	<u>218</u>
Total state and local	<u>(1,759)</u>	<u>(2,954)</u>	<u>(1,189)</u>
Income tax provision	<u><u>\$(42,079)</u></u>	<u><u>\$(39,137)</u></u>	<u><u>\$(15,325)</u></u>

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 4. Income Taxes—(Continued)

The differences between the income tax provision computed by applying the statutory Federal income tax rate to pre-tax income, and the income tax provision reflected in the Consolidated Statements of Income are as follows:

	Year Ended December 31,		
	1996	1997	1998
	(Thousands)		
Statutory tax provision	\$(40,820)	\$(37,742)	\$(10,646)
Impact of:			
Foreign operations	1,848	2,541	1,916
State and local taxes, net of Federal benefits	(1,143)	(1,920)	(774)
Nondeductible goodwill amortization	(4,620)	(4,611)	(9,858)
Percentage depletion	1,668	1,680	1,929
Other, net	988	915	2,108
Income tax provision	<u>\$(42,079)</u>	<u>\$(39,137)</u>	<u>\$(15,325)</u>

The components of the net deferred tax liability are as follows:

	December 31,	
	1997	1998
	(Thousands)	
Deferred tax liabilities related to:		
Property, plant and equipment	\$ 93,603	\$ 95,776
Other	2,201	—
Total deferred tax liabilities	<u>95,804</u>	<u>95,776</u>
Deferred tax assets related to:		
Expenses not yet deducted for tax purposes	(13,558)	(12,323)
Deferred income	(11,092)	(499)
Foreign tax credits not yet utilized under the Tax Sharing Agreement	(4,341)	—
Carryover AMT and R&D credits	—	(7,802)
Other	<u>(5,749)</u>	<u>(25,222)</u>
Total deferred tax assets	<u>(34,740)</u>	<u>(45,846)</u>
Net deferred tax liability	61,064	49,930
Deferred tax assets reclassified to other current assets	6,854	10,352
Noncurrent deferred tax liability	<u>\$ 67,918</u>	<u>\$ 60,282</u>

The Company was a party to tax sharing agreements with members of the GAF consolidated group (the "GAF Group"). As a result of the Separation Transactions, the Company is no longer included in the consolidated Federal income tax returns of GAF, and therefore, such tax sharing agreements are no longer applicable with respect to the tax liabilities of the Company for periods subsequent to the Separation Transactions. The Company remains obligated, however, with respect to tax liabilities imposed or that may be imposed for periods prior to the Separation Transactions. Among other things, those tax sharing agreements provide for the sharing of the GAF Group's consolidated tax liability based on each member's share of the tax as if such member filed on a separate basis. Accordingly, a payment of tax would be made to GAF equal to the Company's allocable share of the GAF Group's consolidated tax liability. Alternatively, the Company would be entitled to refunds if losses or other attributes reduce the GAF Group's consolidated tax liability. Moreover, foreign tax credits generated by the Company not utilized by GAF will be refunded by GAF or its subsidiary to the Company, if such credits expire unutilized upon termination of the statute of limitations for the year of

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 4. Income Taxes—(Continued)

expiration. Furthermore, those tax sharing agreements provide for an indemnification to the Company for any tax liability attributable to another member of the GAF Group.

On September 15, 1997, GAF received a notice from the IRS of a deficiency in the amount of \$84.4 million (after taking into account the use of net operating losses and foreign tax credits otherwise available for use in later years) in connection with the formation in 1990 of Rhône-Poulenc Surfactants and Specialties, L.P. (the "surfactants partnership"), a partnership in which GFC, a subsidiary of GAF, holds an interest. The claim of the IRS for interest and penalties, after taking into account the effect on the use of net operating losses and foreign tax credits, could result in GAF incurring liabilities significantly in excess of the deferred tax liability of \$131.4 million that it recorded in 1990 in connection with this matter. GAF has advised the Company that it believes that it will prevail in this matter, although there can be no assurance in this regard. The Company believes that the ultimate disposition of this matter will not have a material adverse effect on its business, financial position or results of operations. GAF, G-I Holdings and certain subsidiaries of GAF have agreed to jointly and severally indemnify the Company against any tax liability associated with the surfactants partnership, which the Company would be severally liable for, together with GAF and several current and former subsidiaries of GAF, should GAF be unable to satisfy such liability.

Note 5. Acquisitions

Effective April 1, 1998, the Company acquired the remaining 50% interest in GhC, its joint venture with Hüls AG. GhC consists of a manufacturing facility that produces primarily butanediol and tetrahydrofuran. As part of the transaction, the Company also acquired Hüls' production facility that supplies GhC with acetylene, its primary raw material. The results of GhC are included in the Company's financial statements on a consolidated basis from the date of acquisition, including sales of \$53.0 million for 1998.

In February 1998, the Company acquired Polaroid Corporation's Freetown, Massachusetts fine chemicals facility. In connection with the acquisition, the Company entered into a sale-leaseback arrangement for the facility's equipment with a third party. The lease has been accounted for as an operating lease, with an initial term of four years and, at the Company's option, up to three one-year renewal periods. As part of the acquisition transaction, the Company entered into a long-term supply and license agreement with Polaroid for the imaging chemicals and polymers manufactured at the facility and used by Polaroid in its instant film business. The results of the Freetown facility are included in the Company's financial statements from the date of acquisition and were not material to 1998 operations.

Note 6. Sale of Accounts Receivable

In June 1993 the Company sold its domestic trade accounts receivable, without recourse, for a maximum of \$25 million in cash to be made available to the Company based on eligible domestic receivables outstanding from time to time. The agreement under which the Company sells its domestic trade accounts receivable was renewed each year through 1998 for one-year periods on substantially the same terms and conditions, and the maximum purchase amount was increased in January 1998 to provide for up to \$33 million in cash. In January 1999, the agreement was extended for a six-month period through June 1999. The excess of accounts receivable sold over the net proceeds received is included in "Accounts receivable, other." The effective cost to the Company varies with LIBOR or commercial paper rates and is included in "Other income, net" and amounted to \$1.6, \$1.8 and \$1.8 million in 1996, 1997 and 1998, respectively.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 7. Inventories

At December 31, 1997 and 1998, \$52.0 and \$61.8 million, respectively, of domestic inventories were valued using the LIFO method. Inventories comprise the following:

	December 31,	
	1997	1998
	(Thousands)	
Finished goods	\$ 84,912	\$ 87,241
Work in process	20,088	24,862
Raw materials and supplies	18,408	30,065
Total	123,408	142,168
Less LIFO reserve	(3,498)	(3,280)
Inventories	<u>\$119,910</u>	<u>\$138,888</u>

Note 8. Property, Plant and Equipment

Property, plant and equipment comprises the following:

	December 31,	
	1997	1998
	(Thousands)	
Land and land improvements	\$ 72,944	\$ 74,057
Buildings and building equipment	87,574	90,530
Machinery and equipment	509,196	499,160
Construction in progress	65,651	96,875
Total	735,365	760,622
Less accumulated depreciation	(216,443)	(207,427)
Property, plant and equipment, net	<u>\$ 518,922</u>	<u>\$ 553,195</u>

See Note 16 for information regarding capital leases.

Note 9. Long-term Debt and Lines of Credit

Long-term debt comprises the following:

	December 31,	
	1997	1998
	(Thousands)	
9% Senior Notes due 2003	\$324,249	\$324,378
9¾% Senior Notes due 2002	199,871	199,871
9% Senior Notes due 1999	200,000	200,000
Borrowings under revolving credit facility	35,000	132,600
Obligation on mortgaged property, due 1999	38,125	38,125
Obligations under capital leases (Note 16)	1,939	1,317
Other	262	387
Total long-term debt	799,446	896,678
Less current maturities	(684)	(583)
Long-term debt less current maturities	<u>\$798,762</u>	<u>\$896,095</u>

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 9. Long-term Debt and Lines of Credit—(Continued)

In October 1996, the Company issued \$325 million principal amount of 9% Senior Notes due 2003 (the "9% Senior Notes"). The net cash proceeds of \$317.2 million were utilized to consummate a cash tender offer (the "Tender Offer") for all of the Senior Discount Notes and Series B Senior Discount Notes due 1998 (the "Discount Notes") of G-I Holdings.

In October 1996, the Company consummated an offer to exchange (the "Exchange Offer") \$1,000 principal amount of 9¾% Senior Notes due 2002 (the "9¾% Senior Notes") for each \$1,000 principal amount of G-I Holdings' Series B 10% Senior Notes due 2006 (the "10% Notes"). Pursuant to the Exchange Offer, an aggregate amount of \$199.9 million of 9¾% Senior Notes were issued to the former holders of the 10% Notes.

See Note 15 for additional information.

Holders of the 9% Senior Notes and the 9¾% Senior Notes (collectively, the "Notes") have the right to require the Company to purchase the Notes at a price of 101% of their principal amount, and the Company has the right to redeem the Notes at their principal amount plus the Applicable Premium (as defined), together with any accrued and unpaid interest, in the event of a Change of Control (as defined). Under the indentures relating to the Notes, the incurrence of additional debt and the issuance of preferred stock by the Company would be restricted unless, subject to certain exceptions, the ratio of consolidated income before income taxes, interest, depreciation and amortization expense to the consolidated interest expense (as defined) for the most recently completed four fiscal quarters is at least 2 to 1. For the four quarters ended December 31, 1998, the Company was in compliance with such test.

In connection with the issuance of the 9% Senior Notes due March 1999 (the "9% Notes"), the Company entered into interest rate swap agreements ("swaps") with banks in an aggregate notional principal amount of \$200 million. In 1993, the Company terminated the swaps, resulting in gains of \$25.1 million, and entered into new swaps. The gains were deferred and are being amortized as a reduction of interest expense over the remaining life of the 9% Notes. As a result of the new swaps, the effective interest cost to the Company of the 9% Notes varies at a fixed spread over LIBOR. During 1997, the Company entered into five-year swaps with banks in the aggregate notional principal amount of \$100 million in order to fix a portion of its interest expense and reduce its exposure to floating interest rates. These swaps require the Company to pay a fixed rate and receive LIBOR for a period of five years. In 1998, the Company entered into forward-starting swaps in the aggregate notional principal amount of \$125 million in order to convert \$125 million of its exposure to floating interest rates to fixed rates. As of December 31, 1998, such swaps had a maturity of March 1, 1999. Based on the fair value of all of the aforementioned swaps at December 31, 1997 and 1998, the Company would have incurred losses of \$3.3 and \$10.2 million, respectively, representing the estimated amount that would be payable by the Company if the swaps were terminated at such dates.

The Company may be considered to be at risk, to the extent of the costs of replacing such swaps at current market rates, in the event of nonperformance by counterparties. However, since the counterparties are major financial institutions, the credit ratings of which are continually monitored by the Company, the risk of such nonperformance is considered by the Company to be remote.

In July 1996, the Company entered into a new five-year revolving credit facility (the "Credit Agreement") with a group of banks, which provides for loans of up to \$400 million and letters of credit of up to \$75 million. Borrowings under the Credit Agreement bear interest at a floating rate (6.23% on December 31, 1998) based on the banks' base rate, federal funds rate, Eurodollar rate or a competitive bid rate (which may be based on LIBOR or money market rates), at the option of the Company. As of December 31, 1998, letters of credit in the amount of \$7.9 million were outstanding under the Credit Agreement.

The Company has a \$38.1 million mortgage obligation, due April 1999, on its headquarters property. Interest on the mortgage is at a floating rate based on LIBOR. See Note 17.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 9. Long-term Debt and Lines of Credit—(Continued)

Borrowings by the Company, including those under the Credit Agreement, are subject to the application of certain financial covenants contained in such agreement and in the indentures relating to the Notes. As of December 31, 1998, the Company was in compliance with such covenants, and the application of such covenants would not have restricted the amount available for borrowing under the Credit Agreement. The Credit Agreement and the indentures relating to the Notes also limit the amount of cash dividends, purchases of treasury stock, and other restricted payments (as defined) by the Company. As of December 31, 1998, under the most restrictive of such limitations, the Company could have paid dividends and other restricted payments of up to \$56.6 million.

The Credit Agreement and the indentures relating to the Notes contain additional affirmative and negative covenants, including restrictions on liens, investments, transactions with affiliates, sale-leaseback transactions, and mergers and transfers of all or substantially all of the assets of the Company or its subsidiaries. The Credit Agreement also provides for a default if there is a change in control (as defined) of the Company.

The Company believes that the fair value of its non-public variable rate indebtedness approximates the book value of such indebtedness because the interest rates on such indebtedness are at floating short-term rates. The Credit Agreement also provides for adjustments to the interest rate if there is a change in the credit rating of the Company. With respect to the Company's publicly traded debt securities, the Company has obtained estimates of fair values from an independent source believed to be reliable. The estimated fair value of the 9% Senior Notes as of December 31, 1997 and 1998 was \$335.8 and \$341.4 million, respectively, and the estimated fair value of the 9¾% Senior Notes as of December 31, 1997 and 1998 was \$211.1 and \$212.4 million, respectively. The estimated fair value of the 9% Notes as of December 31, 1997 and 1998 was \$205.5 and \$201.0 million, respectively.

The aggregate maturities of long-term debt as of December 31, 1998 for the next five years are as follows:

	<u>(Thousands)</u>
1999	\$ 583
2000	415
2001	132,946
2002	200,040
2003	324,416

In the above table, 1999 maturities exclude the \$200 million of 9% Notes due March 1, 1999 and the \$38.1 million mortgage obligation (see Note 17). Maturities in 2001 include the \$132.6 million of borrowings outstanding under the Credit Agreement as of December 31, 1998, based on the expiration of the Credit Agreement in July 2001. Maturities in 2002 include the \$199.9 million of 9¾% Senior Notes. Maturities in 2003 include the \$324.4 million of 9% Senior Notes, based on their accreted value as of December 31, 1998.

At December 31, 1998, the Company's foreign subsidiaries had total available short-term lines of credit aggregating \$26.9 million, of which \$14.6 million were unused. The weighted average interest rate on the Company's short-term borrowings as of December 31, 1997 and 1998 was 5.7% and 5.5%, respectively.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 10. Benefit Plans

Eligible, full-time employees of the Company are covered by various benefit plans, as described below.

Defined Contribution Plan

The Company provides a defined contribution plan for eligible employees. The Company contributes up to 7% of participants' compensation (any portion of which can be contributed, at the participants' option, in the form of the Company's common stock at a \$.50 per share discount from the market price on the date of contribution), and also contributes fixed amounts, ranging from \$50 to \$750 per year depending on age, to the accounts of participants who are not covered by a Company-provided postretirement medical benefit plan. The aggregate contributions by the Company were \$6.4, \$7.0 and \$8.0 million for 1996, 1997 and 1998, respectively.

Defined Benefit Plans

The Company provides a noncontributory defined benefit retirement plan for certain hourly employees (the "Hourly Retirement Plan"). Benefits under this plan are based on stated amounts for each year of service. The Company's funding policy is consistent with the minimum funding requirements of ERISA.

The Company's net periodic pension cost (income) for the Hourly Retirement Plan included the following components:

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(Thousands)		
Service cost.....	\$ 315	\$ 284	\$ 313
Interest cost.....	1,439	1,481	1,586
Expected return on plan assets.....	(1,733)	(2,152)	(2,366)
Amortization of unrecognized prior service cost.....	174	174	174
Net periodic pension cost (income)	<u>\$ 195</u>	<u>\$ (213)</u>	<u>\$ (293)</u>

The following tables set forth, for the years 1997 and 1998, reconciliations of the beginning and ending balances of the benefit obligation, fair value of plan assets, funded status, amounts recognized in the

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 10. Benefit Plans—(Continued)

Consolidated Balance Sheets and changes in Accumulated Other Comprehensive Income (Loss) related to the Hourly Retirement Plan:

	<u>December 31,</u>	
	<u>1997</u>	<u>1998</u>
	(Thousands)	
Change in benefit obligation:		
Benefit obligation at beginning of year	\$20,031	\$21,718
Service cost	284	313
Interest cost	1,481	1,586
Actuarial losses	755	1,298
Benefits paid	<u>(833)</u>	<u>(900)</u>
Benefit obligation at end of year	<u>21,718</u>	<u>24,015</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	19,076	21,426
Actual return on plan assets	1,833	(358)
Employer contributions	1,350	840
Benefits paid	<u>(833)</u>	<u>(900)</u>
Fair value of plan assets at end of year	<u>21,426</u>	<u>21,008</u>
Reconciliation of funded status:		
Funded status	(292)	(3,007)
Unrecognized prior service cost	1,409	1,235
Unrecognized actuarial losses	<u>693</u>	<u>4,716</u>
Net amount recognized in Consolidated Balance Sheets	<u>\$ 1,810</u>	<u>\$ 2,944</u>
Amounts recognized in Consolidated Balance Sheets:		
Accrued benefit cost	\$ (292)	\$ (3,007)
Intangible asset	1,409	1,235
Accumulated other comprehensive (income) loss	<u>693</u>	<u>4,716</u>
Net amount recognized	<u>\$ 1,810</u>	<u>\$ 2,944</u>
Change for the year in accumulated other comprehensive (income) loss:		
Change in intangible asset	\$ (207)	\$ 174
Change in additional minimum liability	<u>901</u>	<u>3,849</u>
Total	<u>\$ 693</u>	<u>\$ 4,023</u>

In determining the projected benefit obligation, the weighted average assumed discount rate was 7.25% and 7% for 1997 and 1998, respectively. The expected long-term rate of return on assets, used in determining net periodic pension cost (income), was 11% for 1997 and 1998.

The Company also provides a nonqualified defined benefit retirement plan for certain key employees. Expense accrued for this plan was \$0.6, \$0.6 and \$1.0 million for 1996, 1997 and 1998, respectively.

Postretirement Medical and Life Insurance

The Company generally does not provide postretirement medical and life insurance benefits, although it subsidizes such benefits for certain employees and certain retirees. Such subsidies were reduced or ended as of January 1, 1997.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 10. Benefit Plans—(Continued)

The net periodic postretirement benefit cost included the following components:

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
	(Thousands)		
Service cost	\$ 4	\$ 4	\$ 6
Interest cost	805	752	619
Amortization of unrecognized prior service cost	(39)	(179)	(179)
Net periodic postretirement benefit cost	<u>\$ 770</u>	<u>\$ 577</u>	<u>\$ 446</u>

The following table sets forth, for the years 1997 and 1998, reconciliations of the beginning and ending balances of the postretirement benefit obligation, funded status and amounts recognized in the Consolidated Balance Sheets related to postretirement medical and life insurance benefits:

	<u>December 31,</u>	
	<u>1997</u>	<u>1998</u>
	(Thousands)	
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 10,205	\$ 10,324
Service cost	4	6
Interest cost	752	619
Actuarial (gains) losses	214	(968)
Benefits paid	(851)	(732)
Benefit obligation at end of year	<u>10,324</u>	<u>9,249</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	—	—
Employer contributions	851	732
Benefits paid	(851)	(732)
Fair value of plan assets at end of year	<u>—</u>	<u>—</u>
Reconciliation of funded status:		
Funded status	(10,324)	(9,249)
Unrecognized prior service cost	(1,333)	(1,154)
Unrecognized actuarial losses	1,153	185
Net amount recognized in Consolidated Balance Sheets as accrued benefit cost	<u><u>\$(10,504)</u></u>	<u><u>\$(10,218)</u></u>

For purposes of calculating the accumulated postretirement benefit obligation, the following assumptions were made. Retirees as of December 31, 1998 who were formerly salaried employees (with certain exceptions) were assumed to receive a Company subsidy of \$700 to \$1,000 per year. For retirees over age 65, this subsidy may be replaced by participation in a managed care program. With respect to retirees who were formerly hourly employees, most such retirees are subject to a \$5,000 per person lifetime maximum benefit. Subject to such lifetime maximum, a 12% and 6% annual rate of increase in the Company's per capita cost of providing postretirement medical benefits was assumed for 1998 for such retirees under and over age 65, respectively. To the extent that the lifetime maximum benefits have not been reached, the foregoing rates were assumed to decrease gradually to an ultimate rate of 7% and 6%, respectively, by the year 2003 and remain at that level thereafter. The weighted average assumed discount rate used in determining the accumulated postretirement benefit obligation was 7.25% and 7% for 1997 and 1998, respectively.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 10. Benefit Plans—(Continued)

The health care cost trend rate assumption has an effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1997 and 1998 by \$416,000 and \$419,000, respectively, and the aggregate of the service and interest cost components of the net periodic postretirement benefit cost for the years 1997 and 1998 by \$34,000 and \$30,000, respectively. A decrease of one percentage point in each year would decrease the accumulated postretirement benefit obligation as of December 31, 1998 by \$373,000 and the aggregate of the service and interest cost components of the net periodic postretirement benefit cost for the year 1998 by \$27,000.

Note 11. Stock Option Plans and Stock Appreciation Rights

The 1991 Incentive Plan for Key Employees and Directors, as amended (the "Plan"), authorizes the grant of options to purchase a maximum of 9,000,000 shares of the Company's common stock. The Compensation Committee of the Board of Directors (the "Committee") determines the exercise price and vesting schedule of options granted under the Plan. In 1996, 1997 and 1998, the Company granted options to certain employees to purchase 338,645, 264,344 and 2,029,301 shares, respectively, of the Company's common stock at exercise prices ranging from \$.625 to \$5.625 below the fair market value of such shares on the date of grant. The difference between the exercise price and the fair market value of such shares on the date of grant is recognized as compensation expense over the vesting periods of 2½ to 3 years. Compensation expense for such options was \$0.3, \$0.7 and \$1.9 million in 1996, 1997 and 1998, respectively. All other employee options granted under the Plan have a term of nine years, have an exercise price equal to the fair market value of such shares on the date of grant and become exercisable at a rate determined by the Committee at the time of grant. Special vesting rules apply to options granted to non-employee directors.

The Company has elected the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," and applies APB Opinion No. 25 and related interpretations in accounting for the Plan. If the Company had elected to recognize compensation cost based on the fair value of awards under the Plan at grant dates, the Company's pro forma net income for the years 1996, 1997 and 1998 would have been \$53.2, \$51.8 and \$2.2 million, respectively, and pro forma basic earnings per share would have been \$.99, \$.96 and \$.04, respectively. The SFAS No. 123 method of accounting has not been applied to options granted prior to January 1, 1995, and the resulting pro forma compensation expense may not be indicative of pro forma expense in future years.

The fair value of the Company's stock options used to compute pro forma net income and earnings per share is the estimated present value at the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: risk-free interest rate of 6%; expected life of 6 years; expected volatility of 24%; and dividend yield of 0%.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 11. Stock Option Plans and Stock Appreciation Rights—(Continued)

The following is a summary of transactions pertaining to the Plan:

	Year Ended December 31, 1996		Year Ended December 31, 1997		Year Ended December 31, 1998	
	Shares (000's)	Weighted Average Exercise Price	Shares (000's)	Weighted Average Exercise Price	Shares (000's)	Weighted Average Exercise Price
Outstanding, January 1	3,277	\$ 7.86	5,014	\$ 9.32	4,733	\$ 9.68
Granted	2,110	11.31	515	11.99	3,117	15.05
Exercised	(113)	6.90	(306)	8.08	(351)	7.70
Forfeited	(260)	8.17	(490)	9.37	(510)	11.19
Outstanding, December 31	<u>5,014</u>	9.32	<u>4,733</u>	9.68	<u>6,989</u>	12.06
Options exercisable, December 31 ...	<u>1,140</u>	8.45	<u>1,294</u>	8.37	<u>2,190</u>	10.63

Based on calculations using the Black-Scholes option-pricing model, the weighted-average fair value of options granted in 1996, 1997 and 1998 under the Plan for which the exercise price equaled the fair market value of such shares on the date of grant was \$3.50, \$4.17 and \$4.40 per share, respectively, and such weighted average fair value of options granted in 1996, 1997 and 1998 for which the exercise price was less than the fair market value of such shares on the date of grant was \$5.99, \$7.93 and \$6.42 per share, respectively.

The following is a summary of the status of stock options outstanding and exercisable under the Plan as of December 31, 1998:

Range of Exercise Prices	Stock Options Outstanding			Stock Options Outstanding	
	Shares (000's)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Shares (000's)	Weighted Average Exercise Price
\$ 5.00-\$ 7.50	1,250	\$ 6.71	4.04 years	890	\$ 6.63
\$ 7.51-\$11.25	1,198	9.28	5.68 years	340	8.88
\$11.26-\$16.88	4,485	14.21	7.67 years	960	14.96
\$16.89-\$18.63	56	18.33	8.45 years	—	—
Total	<u>6,989</u>	12.06	6.69 years	<u>2,190</u>	10.63

ISP Holdings issued options in 1996 to certain employees to purchase 138,983 shares of ISP Holdings' redeemable convertible preferred stock ("Preferred Stock"), exercisable at a price of \$111.44 per share. Each share of Preferred Stock was convertible, at the holder's option, into shares of common stock of ISP Holdings at a formula price based on the sum of the determined initial Book Value (as defined) plus interest on such Book Value at a specified rate. The options vested over seven years, subject to earlier vesting under certain circumstances including in connection with a change of control.

ISP Holdings also issued stock appreciation rights ("SARs") in 1996 related to 27,748 shares of ISP Holdings' common stock. The SARs represented the right to receive a cash payment based upon the appreciation in value of the specified number of shares of common stock of ISP Holdings over the sum of the determined initial Book Value (as defined) per share of common stock of ISP Holdings plus interest on such Book Value at a specified rate. The SARs vested over a five-year period, subject to earlier vesting under certain circumstances including in connection with a change of control. Compensation expense related to SARs was \$0 for 1996 and \$1.3 million for 1997.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 11. Stock Option Plans and Stock Appreciation Rights—(Continued)

As a result of the Merger (see Note 1), ISP Holdings' Preferred Stock option and SAR programs were terminated, and the Company charged \$7.9 million against operating income for cash payments made in 1998 for amounts vested at that time. Additional accruals totaling \$3.1 million may be made over the remaining vesting period from the date of the Merger through 2003, including \$0.8 million accrued in 1998 after the Merger.

Note 12. Related Party Transactions

BMCA, an indirect subsidiary of GAF and an affiliate of the Company, and its subsidiaries purchase all of their colored roofing granules requirements from the Company (except for the requirements of their California and Oregon roofing plants and a portion of their Indiana roofing plant, which are supplied by a third party) under a requirements contract. Effective January 1, 1999, this contract was amended to cover, among other things, purchases of colored roofing granules by BMCA's subsidiaries and was renewed for 1999. This contract is subject to annual renewal unless terminated by either party to such agreement. In 1998, BMCA and its subsidiaries purchased a total of \$62.6 million of mineral products from the Company, representing 7.6% of the Company's total net sales and 66.2% of the Company's net sales of mineral products. Sales by the Company to BMCA and its subsidiaries totaled \$50.5 and \$51.1 million for 1996 and 1997, respectively. The receivable from BMCA and its subsidiaries for sales of mineral products as of December 31, 1997 and 1998 was \$2.8 and \$5.6 million, respectively.

Pursuant to a management agreement (the "Management Agreement"), the Company has provided certain general management, administrative, legal, telecommunications, information and facilities services to certain of its affiliates, including GAF, BMCA, G-I Holdings and GFC. Charges by the Company for providing such services aggregated \$6.2, \$5.6 and \$5.1 million for 1996, 1997 and 1998, respectively, and are reflected as reductions of "Selling, general and administrative" expense. Such charges consist of management fees and other reimbursable expenses attributable to, or incurred by the Company for the benefit of, the respective parties, which are based on an estimate of the costs the Company incurs to provide such services. Effective January 1, 1999, the term of the Management Agreement was extended through the end of 1999, and the management fees payable by BMCA thereunder were increased. The Company and BMCA also allocate a portion of the management fees payable by BMCA under the Management Agreement to separate lease payments for the use of BMCA's headquarters. Based on the services provided by the Company in 1998 under the Management Agreement, the aggregate amount payable to the Company under the Management Agreement for 1999 is expected to be approximately \$6.1 million.

Note 13. Business Segment Information

The Company has adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which establishes standards for companies to report information about operating segments in annual financial statements, based on the approach that management utilizes to organize the segments within the Company for management reporting and decision making. Business segment and geographic disclosures (see Note 14) for prior periods have been restated to comply with SFAS No. 131.

The Company is a leading multinational manufacturer of a broad spectrum of specialty chemicals, mineral products and filter products. In addition to the Mineral Products and Filter Products segments, the Company operates its Specialty Chemicals business through three reportable business segments, organized based upon the markets for their products and the internal management of the Company, as follows:

Personal Care products serve as critical ingredients in the formulation of many well-known skin care, hair care, toiletry and cosmetic products. Skin care ingredients include sunscreen actives, waterproofing agents, preservatives, emollients and moisturizers. Hair care ingredients include a number of specially formulated fixative resins for hairsprays, mousses and gels, as well as thickeners and stabilizers for shampoos and conditioners.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 13. Business Segment Information—(Continued)

Pharmaceutical, Agricultural and Beverage products are sold to these three government-regulated industries. In the pharmaceutical market, the Company's products serve as key ingredients in prescription and over-the-counter tablets, injectables, cough syrups, antiseptics, toothpastes and denture adhesives. The Company is a leading producer of inert ingredients for the agricultural industry, where the Company's solvents and polymers are used for the formulation of safer and more effective crop treatment products. The Company's specialty polymers serve the beverage market by assuring the clarity and extending the shelf life of beer, wine and fruit juices.

Performance Chemicals, Fine Chemicals and Industrial. The Company's Performance Chemicals business includes acetylene-based polymers, vinyl ether monomers, and advanced materials for industrial applications. The Company's acetylene-based chemistry produces a number of performance polymers for use in a wide range of industrial markets including coatings, adhesives, imaging, detergents, electronics, and metalworking. The Company manufactures a broad range of Fine Chemicals including bulk pharmaceuticals, pharmaceutical intermediates, and pheromones for use in insect population measurement and control. The Company's Industrial business markets several intermediate and solvent products, such as butanediol, tetrahydrofuran (THF) and N-methyl pyrrolidone (NMP), which are sold primarily to industrial markets for use in high performance plastics, lubricating oil and chemical processing, electronics cleaning, and coatings.

Mineral Products. The Company manufactures ceramic-coated colored roofing granules that are sold primarily to the North American roofing industry for use in the production of asphalt roofing shingles.

Filter Products. The Company manufactures a complete line of filter systems for use in the macroscopic filtration of process liquids. Serving primarily the paint, automotive, chemical, pharmaceutical, petroleum, and food and beverage industries, the Company is a global supplier of pressure-rated bag filtration equipment.

The following segment data are presented based on the Company's internal management reporting system for the five reportable business segments. The Company evaluates segment performance based on operating income. Therefore, the measure of profit or loss that is reported to management for each segment is operating income. Interest expense, other income items, income taxes and extraordinary items are not allocated to the business segments for management reporting. At this time, the Company's internal management reporting system does not report assets by segment for the three specialty chemicals reportable segments (Personal Care; Pharmaceutical, Agricultural and Beverage; and Performance Chemicals, Fine Chemicals and Industrial), as many of the Company's plant assets are utilized by several of the segments. Therefore, the following asset-related segment data are presented only for Specialty Chemicals, Mineral Products and Filter Products.

INTERNATIONAL SPECIALTY PRODUCTS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 13. Business Segment Information—(Continued)

Sales of Mineral Products to BMCA and its subsidiaries in 1996, 1997 and 1998 accounted for 59.0%, 61.5% and 66.2%, respectively, of the Company's net sales of Mineral Products, representing 7.1%, 6.8% and 7.6%, respectively, of the Company's total net sales. No other customer accounted for more than 5% of the Company's total net sales in 1996, 1997 or 1998.

	Year Ended December 31,		
	1996	1997	1998
	(Millions)		
Net sales:			
Personal Care	\$ 190.7	\$ 187.4	\$ 189.4
Pharmaceutical, Agricultural and Beverage	194.9	208.4	210.6
Performance Chemicals, Fine Chemicals and Industrial	205.7	230.0	290.1
Total Specialty Chemicals	591.3	625.8	690.1
Mineral Products(1)	85.6	83.1	94.5
Filter Products	39.6	40.3	39.3
Net sales	<u>\$ 716.5</u>	<u>\$ 749.2</u>	<u>\$ 823.9</u>
Operating income:			
Personal Care	\$ 47.6	\$ 44.0	\$ 34.7
Pharmaceutical, Agricultural and Beverage	44.6	46.6	45.8
Performance Chemicals, Fine Chemicals and Industrial	27.1	31.9	54.7
Total Specialty Chemicals	119.3	122.5	135.2
Mineral Products	16.5	17.0	20.5
Filter Products	0.2	3.6	3.6
Total segment operating income	136.0	143.1	159.3
Unallocated corporate office expenses	—	(1.9)	(3.7)
Restructuring and impairment loss(2)	—	—	(73.0)
Merger-related expenses	—	—	(12.8)
Total operating income	136.0	141.3	69.8
Interest expense and other, net	(19.4)	(33.5)	(39.4)
Income from continuing operations before income taxes and extraordinary loss	<u>\$ 116.6</u>	<u>\$ 107.8</u>	<u>\$ 30.4</u>
Assets:			
Specialty Chemicals(3)	\$ 963.8	\$ 985.7	\$1,050.3
Mineral Products	154.5	155.2	157.6
Filter Products	22.0	23.3	26.4
General Corporate(4)	253.4	321.5	531.3
Net current assets of discontinued operations	206.7	—	—
Total assets	<u>\$1,600.4</u>	<u>\$1,485.7</u>	<u>\$1,765.6</u>
Capital expenditures and acquisitions:			
Specialty Chemicals	\$ 41.9	\$ 56.3	\$ 153.7
Mineral Products	9.5	11.2	10.1
Filter Products	3.2	1.0	2.2
Unallocated corporate office	—	0.2	—
Total	<u>\$ 54.6</u>	<u>\$ 68.7</u>	<u>\$ 166.0</u>
Depreciation and goodwill amortization:			
Specialty Chemicals	\$ 41.4	\$ 44.0	\$ 50.3
Mineral Products	9.6	10.1	11.8
Filter Products	0.5	0.6	0.8
Unallocated corporate office	—	0.5	2.2
Total	<u>\$ 51.5</u>	<u>\$ 55.2</u>	<u>\$ 65.1</u>

(1) Includes sales to BMCA and its subsidiaries of \$50.5, \$51.1 and \$62.6 million for 1996, 1997 and 1998, respectively.

(Footnotes continued on next page)

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 13. Business Segment Information—(Continued)

(Footnotes continued from previous page)

- (2) Of the \$73.0 million restructuring and impairment loss in 1998, \$70.0 million relates to the Performance Chemicals, Fine Chemicals and Industrial business segment. The remaining \$3.0 million provision relates to the consolidation of European offices and affects all business segments except Mineral Products.
- (3) Identifiable assets of Specialty Chemicals as of December 31, 1996 and 1997 include the Company's 50% ownership of GhC. See Notes 2 and 5.
- (4) General Corporate assets primarily represent the Company's investments in trading, available-for-sale and held-to-maturity securities and other short-term investments, which are held for general corporate purposes and are not allocated to industry segments.

Note 14. Geographic Information

Financial information set forth below for foreign operations represent sales and long-lived assets (property, plant and equipment) of foreign-based subsidiaries. Net sales are attributed to countries based on location of customers and reflect the Company's internal management reporting system.

	<u>Year Ended December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
	<u>(Millions)</u>		
Net sales:			
North America:			
United States	\$350.6	\$376.9	\$413.0
Canada	14.4	15.8	17.5
Total North America	<u>365.0</u>	<u>392.7</u>	<u>430.5</u>
Europe:			
Germany(1)	49.1	39.0	93.0
United Kingdom	39.5	39.2	39.1
France	23.9	22.7	23.8
Italy	14.9	17.2	16.8
Switzerland	10.8	14.7	13.2
Other European countries	75.0	70.1	71.9
Total Europe	<u>213.2</u>	<u>202.9</u>	<u>257.8</u>
Asia-Pacific:			
Japan	36.4	39.5	26.3
Australia	12.6	12.7	12.1
Taiwan	9.6	14.0	13.7
Other Asia-Pacific countries	44.4	46.4	40.3
Total Asia-Pacific	<u>103.0</u>	<u>112.6</u>	<u>92.4</u>
Latin America:			
Brazil	13.7	15.5	16.9
Mexico	8.5	9.8	12.1
Other Latin American countries	13.1	15.7	14.2
Total Latin America	<u>35.3</u>	<u>41.0</u>	<u>43.2</u>
Total net sales	<u>\$716.5</u>	<u>\$749.2</u>	<u>\$823.9</u>

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 14. Geographic Information—(Continued)

	December 31,		
	1996	1997	1998
	(Millions)		
Property, Plant and Equipment:			
United States	\$473.8	\$501.9	\$479.6
Germany(2)	0.4	0.4	53.6
All other foreign countries	15.3	16.6	20.0
Total Property, Plant and Equipment	<u>\$489.5</u>	<u>\$518.9</u>	<u>\$553.2</u>

(1) Net sales for Germany for 1996 and 1997 do not include sales of the GhC joint venture, which was accounted for by the equity method prior to the Company's acquisition, effective April 1, 1998, of the remaining 50% interest in GhC. See Notes 2 and 5.

(2) The Company's other principal long-lived asset in Germany as of December 31, 1996 and 1997 was the 50% ownership of GhC of \$38.2 and \$34.3 million, respectively. See Notes 2 and 5.

Approximately 50% of the Company's sales in 1998 were in foreign countries which are subject to currency exchange rate fluctuation risks. See Note 2 for a discussion of the Company's policy to manage these risks. Certain countries in which the Company has sales are subject to additional risks, including high rates of inflation, exchange controls, government expropriation and general instability.

Note 15. Discontinued Operations

On August 1, 1996, ISP Holdings completed the sale of WAXQ—FM, a commercial radio station operated by GAF Broadcasting Company, Inc. ("GAF Broadcasting"), which was a wholly-owned subsidiary of ISP Holdings, for a purchase price of \$90.0 million. The gain on disposal of \$43.6 million, after income taxes of \$30.6 million, was recorded in the third quarter of 1996. Accordingly, GAF Broadcasting is reported as a discontinued operation.

As a result of the Separation Transactions, G-I Holdings and its remaining assets, principally the building materials business, consisting of BMCA and U.S. Intec, and the assets and liabilities of GFC, as well as GAF Broadcasting, are reflected as discontinued operations in the Consolidated Financial Statements for periods prior to the Separation Transactions. Summary operating results of such discontinued operations are as follows:

	Year Ended December 31, 1996
	(Thousands)
Net sales	<u>\$856,200</u>
Loss before income taxes	\$ (28,015)
Income tax benefit	8,425
Loss from discontinued operations(1)	<u>\$ (19,590)</u>

(1) Loss from discontinued operations is net of elimination of intercompany interest, net of income taxes.

In February 1996, G-I Holdings completed the exchange of \$189.3 million in accreted value of its then-outstanding Discount Notes, for \$200 million of its 10% Notes, which were subsequently subject to the Exchange Offer discussed in Note 9. As discussed in Note 9, on October 18, 1996, ISP Holdings consummated the Tender Offer for G-I Holdings' Discount Notes. Pursuant to the Tender Offer, \$346.9 million in accreted value of G-I Holdings' Discount Notes were purchased by ISP Holdings and \$133.0 million in accreted value of such Discount Notes were subsequently repurchased by G-I Holdings (utilizing cash on hand and the repayment of

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 15. Discontinued Operations—(Continued)

monies owed to G-I Holdings by ISP) from ISP Holdings. G-I Holdings also purchased additional Discount Notes from ISP Holdings for an aggregate cash purchase price of \$45.8 million, representing the sum of \$45.0 million plus an amount sufficient to pay ISP Holdings' fees and expenses related to the Separation Transactions (to the extent not previously included in the repurchase of Discount Notes by G-I Holdings). ISP Holdings also concluded an offer to exchange its 9¾% Senior Notes for G-I Holdings' 10% Notes. Pursuant to the Exchange Offer, \$199.9 million of G-I Holdings' 10% Notes were acquired by ISP Holdings.

All Discount Notes purchased in the Tender Offer (other than those Discount Notes sold to G-I Holdings, as discussed above) and all 10% Notes accepted in the Exchange Offer by ISP Holdings were contributed to G-I Holdings by ISP Holdings as a capital contribution in December 1996, prior to the Separation Transactions, and canceled by G-I Holdings.

In connection with these transactions, the Company recorded extraordinary losses of \$31.0 million, net of related income tax benefits of \$17.3 million, representing write-offs of deferred financing fees and the premium to accreted value of \$29.4 million paid pursuant to the Tender Offer.

Note 16. Commitments and Contingencies

Asbestos Litigation Against GAF

GAF has advised the Company that, as of December 28, 1998, it is defending approximately 113,800 pending lawsuits involving alleged asbestos-related bodily injury claims relating to the inhalation of asbestos fiber ("Asbestos Claims") (having received notice of approximately 93,500 new Asbestos Claims during 1998) and has resolved approximately 293,500 Asbestos Claims (including approximately 59,000 in 1998). GAF has advised the Company that it believes that a significant portion of the claims filed in 1998 were already pending against other defendants for some period of time, with GAF being added as a defendant upon the lifting in 1997 of the injunction relating to the *Georgine* class action settlement. This injunction prevented plaintiffs from filing or proceeding with their Asbestos Claims other than in accordance with the *Georgine* class action settlement, which was rendered inoperable in 1997 by a United States Supreme Court ruling. GAF's current estimated average cost for Asbestos Claims resolved in 1998 (including Asbestos Claims disposed of at no cost to GAF) is approximately \$3,500 per claim. Substantially all of the costs in respect of these Asbestos Claims will be paid over several years. There can be no assurance that the actual costs of resolving pending and future Asbestos Claims will approximate GAF's estimated average costs for the Asbestos Claims resolved in 1998.

GAF has stated that it is committed to effecting a comprehensive resolution of Asbestos Claims, and that it is exploring a number of options to accomplish such resolution. There can be no assurance that this effort will be successful.

Neither the Company nor the assets or operations of the Company, which was operated as a division of a corporate predecessor of GAF prior to July 1986, have been involved in the manufacture or sale of asbestos products. The Company believes that it should have no legal responsibility for damages in connection with asbestos-related claims. Should GAF, however, be unable to satisfy judgments against it in asbestos-related lawsuits, its judgment creditors might seek to enforce their judgments against the assets of GAF and, in that regard, seek to recapture assets distributed by GAF, including assets distributed in the Separation Transactions. Although the Company does not believe any such action to unwind the Separation Transactions would be successful, there can be no assurance in that regard. If a creditor were successful in recapturing assets distributed in the Separation Transactions, such creditor could seek to enforce any asbestos-related judgment against GAF's assets, including the capital stock of the Company, and such enforcement could result in a change of control of the Company. See Note 9 for discussion of the Credit Agreement.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 16. Commitments and Contingencies—(Continued)

Environmental Litigation

The Company, together with other companies, is a party to a variety of proceedings and lawsuits involving environmental matters ("Environmental Claims"), in which recovery is sought for the cost of cleanup of contaminated sites, a number of which Environmental Claims are in the early stages or have been dormant for protracted periods.

The Company estimates that its liability in respect of all Environmental Claims (including those relating to its closed Linden, New Jersey plant described below), as of December 31, 1998, is approximately \$20.0 million, before reduction for insurance recoveries reflected on the Company's balance sheet (discussed below) of \$10.7 million that relate to both past expenses and estimated future liabilities ("estimated recoveries"). The gross environmental liability is included within "Accrued liabilities" and "Other liabilities," and the estimated recoveries are included within "Other current assets" and "Other assets."

In the opinion of the Company's management, the resolution of the Environmental Claims should not be material to the business, liquidity, results of operations, cash flows or financial position of the Company. However, adverse decisions or events, particularly as to the liability and the financial responsibility of the Company's insurers and of the other parties involved at each site and their insurers, could cause the Company to increase its estimate of its liability in respect of such matters. It is not currently possible to estimate the amount or range of any additional liability.

After considering the relevant legal issues and other pertinent factors, the Company believes that it will receive the estimated recoveries and the legal expenses incurred on the Company's behalf and that the recoveries could be well in excess of the current estimated liability for all Environmental Claims, although there can be no assurances in this regard. The Company believes it is entitled to substantially full defense and indemnity under its insurance policies for most Environmental Claims, although the Company's insurers have not affirmed a legal obligation under the policies to provide indemnity for such claims.

In March 1995, GAF commenced litigation on behalf of itself and its predecessors, successors, subsidiaries and related corporate entities seeking amounts substantially in excess of the estimated recoveries. While the Company believes that its claims are meritorious, there can be no assurance that the Company will prevail in its efforts to obtain amounts equal to, or in excess of, the estimated recoveries.

In June 1989, the Company entered into a Consent Order with the New Jersey Department of Environmental Protection ("NJDEP") requiring the development of a remediation plan for its closed Linden, New Jersey plant and the maintenance of financial assurances (currently \$7.5 million) to guarantee the Company's performance. This Consent Order does not address any potential natural resource damage claims. In April 1993, NJDEP issued orders which require the prevention of discharge of contaminated groundwater and stormwater from the site and the elimination of other potential exposure concerns. The Company believes, although there can be no assurance, that, taking into account its plans for development of the site, it can comply with the NJDEP order at a cost of no more than \$7.5 million.

Lease Commitments

Leases for certain equipment at the Company's mineral products plants are accounted for as capital leases and are included in "Property, plant and equipment, net," at December 31, 1997 and 1998 in the amount of \$2.1 and \$2.2 million, respectively. The Company also has operating leases related to the sale-leaseback transaction discussed in Note 5 and for transportation, production and data processing equipment and for various buildings. Rental expense on operating leases was \$8.7, \$9.7 and \$15.2 million for 1996, 1997 and 1998, respectively.

INTERNATIONAL SPECIALTY PRODUCTS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 16. Commitments and Contingencies—(Continued)

Future minimum lease payments for properties which were held under long-term noncancelable leases as of December 31, 1998 were as follows:

	<u>Capital Leases</u>	<u>Operating Leases</u>
	(Thousands)	
1999	\$ 488	\$ 9,391
2000	434	8,326
2001	339	7,239
2002	137	6,252
2003	140	5,893
Later years	—	7,423
Total minimum payments	1,538	<u>\$44,524</u>
Less interest included above	221	
Present value of net minimum lease payments	<u>\$1,317</u>	

Other Matters

The Company has received site designation from the New Jersey Hazardous Waste Facilities Siting Commission for the construction of a hazardous waste treatment, storage and disposal facility at its Linden, New Jersey property and has received approval from the New Jersey Turnpike Authority for a direct access ramp from the Turnpike to the site. If the Company is successful in securing the necessary permits to construct and operate the hazardous waste facility, the Company intends to develop and operate the facility in a separate subsidiary, either on its own or in a joint venture with a suitable partner. The Company estimates that the cost of constructing the facility will be approximately \$100 million and, if approved, the facility is anticipated to be in operation three years after commencement of construction. The Company anticipates utilizing internally generated cash and/or seeking project or other independent financing for this project. Accordingly, the Company would not expect such facility to impact materially its liquidity or capital resources. The Company is also investigating additional development opportunities at this site.

See Note 4 for information regarding additional contingencies.

Note 17. Subsequent Events

On March 1, 1999, the Company repaid its 9% Senior Notes due March 1999 with \$200 million of long-term Credit Agreement borrowings. On March 1, 1999, the Company also terminated the forward-starting interest rate swaps entered into in 1998 in the aggregate notional amount of \$125 million. The cost to the Company to terminate such swaps was insignificant. On March 18, 1999, the Company received a one-year extension, to April 11, 2000, on its \$38.1 million mortgage obligation.

INTERNATIONAL SPECIALTY PRODUCTS INC.

SUPPLEMENTARY DATA (UNAUDITED)

Quarterly Financial Data (Unaudited)

	1997 by Quarter				1998 by Quarter			
	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
	(Millions)							
Net sales	\$191.2	\$197.8	\$183.6	\$176.6	\$200.7	\$219.8	\$206.9	\$196.5
Cost of products sold	<u>114.2</u>	<u>116.3</u>	<u>105.9</u>	<u>100.5</u>	<u>119.2</u>	<u>125.7</u>	<u>119.6</u>	<u>120.8</u>
Gross profit.....	<u>\$ 77.0</u>	<u>\$ 81.5</u>	<u>\$ 77.7</u>	<u>\$ 76.1</u>	<u>\$ 81.5</u>	<u>\$ 94.1</u>	<u>\$ 87.3</u>	<u>\$ 75.7</u>
Operating income (loss)(1)	<u>\$ 36.4</u>	<u>\$ 39.0</u>	<u>\$ 34.6</u>	<u>\$ 31.3</u>	<u>\$ 37.8</u>	<u>\$ 48.1</u>	<u>\$ 23.6</u>	<u>\$ (39.7)</u>
Income (loss) before income taxes	\$ 25.2	\$ 28.8	\$ 28.5	\$ 25.3	\$ 31.2	\$ 38.8	\$ 18.3	\$(57.9)
Income tax (provision) benefit...	(9.2)	(10.4)	(10.5)	(9.0)	(11.3)	(14.8)	(6.9)	17.7
Minority interest in income of subsidiary	<u>(3.8)</u>	<u>(3.9)</u>	<u>(3.6)</u>	<u>(3.4)</u>	<u>(4.2)</u>	<u>(5.0)</u>	<u>(1.1)</u>	<u>—</u>
Net income (loss)	<u>\$ 12.2</u>	<u>\$ 14.5</u>	<u>\$ 14.4</u>	<u>\$ 12.9</u>	<u>\$ 15.7</u>	<u>\$ 19.0</u>	<u>\$ 10.3</u>	<u>\$ (40.2)</u>
Earnings per common share(2):								
Basic	<u>\$.23</u>	<u>\$.27</u>	<u>\$.27</u>	<u>\$.24</u>	<u>\$.29</u>	<u>\$.35</u>	<u>\$.15</u>	<u>\$ (.58)</u>
Diluted.....	<u>\$.23</u>	<u>\$.27</u>	<u>\$.27</u>	<u>\$.24</u>	<u>\$.29</u>	<u>\$.35</u>	<u>\$.15</u>	<u>\$ (.58)</u>

- (1) Operating income for the third quarter of 1998 reflects \$12.8 million of merger-related expenses and \$3.0 million of restructuring charges related to the consolidation of offices in the Company's European operations. Operating income (loss) for the fourth quarter of 1998 reflects \$70.0 million of restructuring and impairment losses. See Note 3 to Consolidated Financial Statements.
- (2) Earnings per share are calculated separately for each quarter and the full year. Accordingly, annual earnings per share will not necessarily equal the total of the quarters. Earnings per share for all periods prior to the Merger are calculated based on the 53,833,333 shares of the Company's common stock held by ISP Holdings' stockholders. See Note 1 to Consolidated Financial Statements.

INTERNATIONAL SPECIALTY PRODUCTS INC.
VALUATION AND QUALIFYING ACCOUNTS

Year Ended December 31, 1996
(Thousands)

<u>Description</u>	<u>Balance January 1, 1996</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance December 31, 1996</u>
Valuation and Qualifying Accounts Deducted from Assets to Which They Apply:				
Allowance for doubtful accounts	\$ 2,879	\$ 272	\$ 311(a)	\$ 2,840
Reserve for inventory market valuation	13,978	8,329	9,495	12,812

Year Ended December 31, 1997
(Thousands)

<u>Description</u>	<u>Balance January 1, 1997</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Balance December 31, 1997</u>
Valuation and Qualifying Accounts Deducted from Assets to Which They Apply:				
Allowance for doubtful accounts	\$ 2,840	\$ 338	\$ 454(a)	\$ 2,724
Reserve for inventory market valuation	12,812	7,631	6,360	14,083

Year Ended December 31, 1998
(Thousands)

<u>Description</u>	<u>Balance January 1, 1998</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions</u>	<u>Other</u>	<u>Balance December 31, 1998</u>
Valuation and Qualifying Accounts Deducted from Assets to Which They Apply:					
Allowance for doubtful accounts	\$ 2,724	\$ 258	\$ 291(a)	\$ 98(b)	\$ 2,789
Reserve for inventory market valuation	14,083	15,595	7,762	127(b)	22,043
Reserves for restructuring	—	10,503	1,161	—	9,342

Notes:

(a) Represents write-off of uncollectible accounts net of recoveries.

(b) Represents balance acquired in acquisitions.

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International Specialty Products Inc.*

Harrison J. Goldin
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Peter R. Heinze, Ph.D.
*President and Chief Operating Officer,
International Specialty Products Inc.*

Samuel J. Heyman
*Chairman of the Board and Chief Executive Officer,
International Specialty Products Inc.*

Sanford Kaplan
Private Investor

Burt Manning
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Personal Care and Fine Chemicals*

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Performance Chemicals and Pharmaceutical,
Agricultural and Beverage Products*

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Supply Chain Management*

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*Vice President,
Personal Care Global Sales*

Robert M. Mininni, Ph.D.
*Vice President,
Research & Development*

Joseph Nassif
*Vice President,
Hair Care*

Christopher W. Nolan
*Vice President,
Corporate Development
and Investor Relations*

Joseph J. Okaly
*Vice President and
General Manager,
Mineral Products*

Joseph D. Pope
*Vice President,
Litigation and Legal Affairs*

Seth H. Ruzi
*Vice President,
Corporate Real Estate*

Paul Taylor, Ph.D.
*Vice President,
Business Development and
External Technology*

Susan B. Yoss
Vice President and Treasurer

ISP FACILITIES

UNITED STATES

MANUFACTURING FACILITIES

Alabama, Huntsville
Kentucky, Calvert City
Massachusetts, Freetown
Missouri, Annapolis
New Jersey, Belleville
New Jersey, Chatham
Ohio, Columbus
Pennsylvania, Blue Ridge Summit
Tennessee, Memphis
Texas, Seadrift
Texas, Texas City
Wisconsin, Pembine

RESEARCH LABORATORIES

Alabama, Huntsville
Kentucky, Calvert City
Maryland, Hagerstown
Massachusetts, Freetown
New Jersey, Belleville
New Jersey, Chatham
New Jersey, Wayne
Ohio, Columbus
Texas, Texas City

SALES OFFICES

California, Sherman Oaks
Illinois, Lombard
Maryland, Hagerstown
New Jersey, Belleville
New Jersey, Bridgewater
New Jersey, Chatham
New Jersey, Wayne
North Carolina, Charlotte
Ohio, Cleveland
Ohio, Columbus
Tennessee, Memphis
Texas, Dallas

INTERNATIONAL

MANUFACTURING FACILITIES

Belgium, Sint-Niklaas
Brazil, São Paulo
Canada, Oakville, Ontario
Germany, Hamburg
Germany, Marl
Singapore

RESEARCH LABORATORIES

Belgium, Sint-Niklaas
China, Shanghai
Germany, Cologne
Singapore
United Kingdom, Guildford

SALES OFFICES

Argentina, Buenos Aires
Australia, Box Hill, Victoria
Australia, Silverwater, N.S.W.
Austria, Vienna
Belgium, Sint-Niklaas
Brazil, São Paulo
Bulgaria, Sofia
Canada, Mississauga, Ontario
China, Beijing
China, Chengdu
China, Guangzhou
China, Hong Kong
China, Shanghai
Colombia, Bogotá
Czech Republic, Prague
Denmark, Copenhagen
Finland, Helsinki
France, Paris
Germany, Cologne
Hungary, Budapest
India, Bombay
India, Hyderabad
Indonesia, Jakarta
Italy, Milan
Japan, Osaka
Japan, Tokyo
Korea, Seoul
Malaysia, Kuala Lumpur
Mexico, Mexico City
Netherlands, Schiedam
Poland, Warsaw
Puerto Rico, Caguas
Russia, Moscow
Singapore
Spain, Barcelona
Sweden, Arsta
Switzerland, Baar
Taiwan, Taipei
Thailand, Bangkok
Turkey, Istanbul
United Kingdom, Manchester
Venezuela, Caracas

JOINT VENTURE

MANUFACTURING FACILITY

India, Nagpur
Chemfields Pharmaceuticals Pvt. Ltd.

ADDITIONAL INFORMATION

ANNUAL MEETING

The 1999 Annual Meeting of Shareholders is scheduled to be held at 10:00 a.m., Monday May 24, 1999 at:

Well, Gauthal & Manges LLP
767 Fifth Avenue
25th Floor
New York, New York 10153

FORM 10-K

Additional copies of the Company's Annual Report on Form 10-K (including financial statements and schedules), as filed with the Securities and Exchange Commission, may be obtained free of charge by writing to:

International Specialty Products
Shareholder Relations Department
1361 Alps Road
Wayne, New Jersey 07470

Or you may call: (800) 526-3315

STOCK TRANSFER AGENT AND REGISTRAR

The Bank of New York
101 Barclay Street
New York, New York 10007
Telephone: (800) 524-4458

INVESTOR RELATIONS

Inquiries should be directed to:
Christopher W. Nolan
Vice President, Corporate Development
and Investor Relations
International Specialty Products
1361 Alps Road
Wayne, New Jersey 07470
Telephone: (973) 628-3463
e-mail: cnolan@ispcorp.com

International Specialty Products Inc.
common stock is listed on the New York
Stock Exchange (symbol: "ISP").

Visit our Internet website at
<http://www.ispcorp.com>



1361 ALPS ROAD
WAYNE, NEW JERSEY 07470

www.ispcorp.com